



## MEMORANDUM

---

---

**TO: Mr. Scott Dinwiddie**  
**U.S. Department of the Treasury**

**FROM: Thom Amdur**  
**President, National Association for Opportunity Zone Investment**  
**202-939-1753, tamdur@dworbell.com**

**RE: National Association for Opportunity Zone Investment**

**DATE: December 28, 2018**

---

---

This Memorandum raises issues that are perceived as “open” pending guidance to be issued from Treasury regarding the operation and application of the Opportunity Zone Program (OZP) created by the Tax Cuts and Jobs Act passed in December 2017 and set forth in Sections 1400Z-1 and 2 of the Internal Revenue Code of 1986, as amended (the Code). While some have suggested that the new statute does not constitute a “program” in the absence of reporting requirements and some mechanism to measure the social and economic benefits of the statute, we will refer to the statute as a program as a shorthand reference to its purpose of directing investments to economically distressed census tracts designated by elected government officials and the totality of requirements established by the statute. This letter is being submitted following the issuance of proposed regulations by the Department of the Treasury (Treasury) on October 29, 2018 (Guidance). We understand that Treasury is working on additional guidance and hope that this letter will prove helpful in the preparation of that guidance.

Once again, we thank Treasury and the Internal Revenue Service (Service) for their efforts in administering this important new statute and for communicating with those interested in participating in the OZP. We note that the taxpayer incentives created by the OZP are a wasting asset. The value of the initial deferral of gain diminishes with each passing year and the ability to secure interim basis increases will vanish at the end of 2019 and 2021. In light of the diminishing incentive under the program, speed of implementation is critical. We believe that President Trump, Senator Scott and other Congressional proponents of the OZP have encouraged taxpayers to participate in the OZP even as the details of the OZP are being worked out. The National Association for Opportunity Zone Investment desires to follow the lead of OZP proponents to unlock the investment dollars currently sitting on the sidelines and to bring economic development to the severely distressed census tracts selected by the chief executive officers of each state. The states have done their part, Treasury and the Service have assisted with the anticipated issuance of regulations, and now the private sector needs to find a modest quantity of additional assurance to place significant amounts of capital at risk. We hope the price of being pioneers will be limited to additional transaction costs to address uncertainties and will not extend to loss of anticipated

returns when reasonable interpretations of uncertain statutory positions have been adopted in opportunity zone investments.

The members of the National Association for Opportunity Zone Investment have begun closing transactions that are consistent with the current guidance and the recommendations contained herein. To the extent that Treasury subsequently issues guidance that would be more restrictive than the recommendations outlined herein, we would respectfully request that the guidance provide for a prospective effective date. Only with the prospective application of additional guidance will a sufficient level of comfort for opportunity zone capital investments be established.

We believe that the recommendations contained herein are both conservative and reasonable, and that strong arguments may be made to lengthen investment periods, or provide more favorable applications of the provisions of Code Sections 1400Z-1 and 2. In that regard, this memorandum is an effort to establish something approaching an informal safe harbor for plain vanilla, prudent and “down the middle of the fairway” transactions. In that spirit, we look forward to reasoning together about the recommendations contained herein. Again, we thank you in advance for your consideration of our submission and for meeting with us.

The following issues are organized under structural headings. We have selected these issues after meetings with OZI Members to identify the issues of most importance to participants in the OZP. We believe that resolution of these issues will significantly increase the number of transactions that will be able to close in calendar year 2019.

## **I. Entity Qualification Issues.**

***QOF Qualifications.*** A Qualified Opportunity Fund (QOF) should have a reasonable amount of time to invest the proceeds of capital contributions received by the QOF. Pursuant to Code Section 1400Z-2(e)(4)(B), Treasury is authorized to establish a reasonable period of time for a QOF to reinvest returns of capital received by a QOF. This authority should permit Treasury to establish a reasonable period of time to make its initial investment. In so doing, Treasury should attempt to accommodate normal commercial practices. Investment closings are often delayed for a variety of reasons. Frequently, the recipient of a capital investment wants to ensure that the potential investor has actually received the funds that it is committing to invest. Likewise, an investor may want assurance that an investment opportunity is fully “baked”. The sponsor of a QOF will attempt to match investors with specific investment opportunities. All of this takes time and a QOF needs to be able to have a reasonable time to invest the funds that it receives.

In the Guidance, Treasury adopted rules intended to be as favorable as possible to taxpayers while implementing the 6-month and year end averaging rule. The rules have the effect of giving calendar year QOFs created close to the end of the calendar year only a few weeks or even a few days to make investments into Qualified Opportunity Zone Businesses (QOZB). This restrictive time frame presents substantial difficulties to QOFs. We recommend that Treasury ameliorate this hardship by providing a 6-month working capital exception for purposes of applying the two tests.

## II. Structural Issues

**A. *Treatment of Debt.*** Code Section 1400Z-2(e)(1) requires a QOF to restrict the benefit of the OZP to the portion of the funds that it receives from gain as to which an election under Code Section 1400Z-2(a) has been made. Where funds are received from sources other than elected gain, the QOF is “mixed” and the OZP benefits are diluted. We believe that a QOF that is not a “mixed” QOF should qualify for a 100% basis increase if it invests at least 90% of its assets in QOZPI or QOZS and holds that investment for ten years. We submit that the 100% exclusion should remain effective even if the corporation (QOZC) or the partnership (QOZPS) that operates a QOZB borrows funds in the conduct of its business. In this context, the same rule should apply to both corporate and partnership entities that operate a QOZB. Indebtedness at the QOZB level is fully consistent with the normal business operation of domestic entities. Opportunity Zone businesses should not be hobbled by rules that don’t apply to other, competing businesses in their neighborhood. It should be a goal of the OZP to encourage business expansion and increased investment in the relevant Opportunity Zone. Whether that expansion is funded by debt or equity should not dilute the OZP benefits of the OZP investor from its original investment. Certainly funds raised through additional capital contributions from equity owners who are not investing through a QOF should not cause the QOF to dilute the basis step-up benefit if the QOF disposes of its interest in the corporation or partnership that conducts the QOZB. The issue is clearer with respect to a corporate entity, but the treatment of partnership indebtedness as an increase in the basis of a partner’s interest to the extent of the partner’s allocable share of the indebtedness under the normal application of partnership tax rules should not trigger the application of the “mixed” fund rules.

**B. *Basis.*** An investor does not initially receive basis in an investment in a QOF. The QOF should obtain basis in either assets operated directly as a QOZB, or in the stock of a QOZC, or in a partnership interest acquired in a QOZPS. Likewise, a QOZC or a QOZPS should acquire basis in the assets that it acquires with the proceeds of investments as to which an election is made pursuant to Code Section 1400Z-2(a). Guidance with respect to the calculation of basis is crucial to the determination of the treatment of distributions from QOZCs and QOZPS, and determining whether QOZCs and QOZPS may invest in properties that would qualify for federal low-income housing tax credits, historic tax credits or renewable energy credits.

We start from the premise that normal partnership tax rules should apply to the allocation of income and loss incurred by a QOZPS and normal corporate federal income tax rules should be applied to the operations of a QOZC. As noted above, a taxpayer’s initial basis in a QOF is zero and that initial basis is increased for QOF investments that are held for at least 5 years, again for QOF investments that are held for at least 7 years and finally on December 31, 2026 when any taxable gain on the original sale is included in the taxpayer’s gross income. These basis increases should not serve to increase the basis of any QOZC, QOZPS or QOZBP acquired by a QOF, assuming that the QOF received basis upon the acquisition of the QOZPs or QOZC.

The basis of a QOF’s interest in a QOZPS should include indebtedness incurred by the QOZPS and allocated to the QOF under normal partnership rules. We will address distribution issues below, but inclusion of QOZPS debt in partnership basis will permit distributions made by a QOZPS to be treated under normal rules and achieve a more predictable result. Moreover, a QOZPS will be subject to compliance testing and will, under the non-qualified financial property tests, be unable to hold cash deposits for an extended period to time distributions so as to avoid redemption treatment.

### III. Operational Issues

**A. *Distributions.*** Distributions of earnings and profits from a QOZC calculated under normal federal income tax rules should not dilute subsequent basis increases under Code Section 1400Z-2(c). Distributions made by a QOZB conducted in a partnership form should be treated under normal partnership distribution rules.

Redemptions with respect to an equity investment in a QOZB entity should be treated as a disposition of a portion of the QOZ equity investment. Redemption proceeds that are reinvested in a QOZB within a reasonable period of time as contemplated in Code Section 1400Z-2(e)(4)(B) should neither be currently taxable to the recipient of the dividend nor dilute future exclusion of gain. Redemptions of the stock of a corporation should be characterized under Code Section 302. A similar rule should apply to QOZB conducted through a partnership and a safe harbor should be created for partnership distributions similar to the proposed regulations under the New Markets Tax Credit program.

**B. *Form of Disposition.*** The form of a disposition of an Opportunity Zone investment should not change the ability of the taxpayer who has made a valid election under Code Section 1400Z-2 to increase its basis in an Opportunity Zone investment. This discussion will assume that all of the requirements of the OZP have been met and that the taxpayer has held its investment in excess of 10 years. It is clear that a taxpayer in those circumstances could step up its basis in the QOF to fair market value. If the QOF operates QOZBP directly, it should be able to sell the QOZBP assets at a gain and liquidate without the investor paying federal income tax. Where a QOF holds interests in a QOZC or a QOZPS, the issues become more difficult. It will be a rare situation where the prospective purchaser of a QOZB will be willing to purchase an interest in an entity that may be two steps removed from the assets that the purchaser wishes to acquire. In most situations, it is difficult to convince a purchaser to buy the equity interests in an entity that directly holds business assets instead of the assets themselves. This is particularly true with respect to real estate investments. In such a case, the purchaser is likely to purchase assets, followed by a distribution of sale proceeds in liquidation of the QOZPS or QOZC. In either case, the QOF should be able to dispose of its indirectly held QOZB assets without the imposition of federal income tax. Other, non-OZP shareholders or partners should not be permitted to increase their basis in the QOZPS or QOZC to eliminate non-qualified OZP gain. To achieve this result, the QOF must be able to increase its basis in the QOZPS or QOZC to fair market value.

**C. *Interim Sales.*** Code Section 1400Z-2(e)(4) authorizes Treasury to issue regulations to ensure that a QOF that disposes of QOZC or QOZPS interests will have a reasonable period of time to reinvest sale proceeds in another QOZB to avoid the recognition of gain and to retain its ability to increase the basis of its investment to fair market value after the ten-year holding period is met. We believe that a reasonable reinvestment period would be at least 12 months.

There are some additional questions that arise. During the reinvestment period, the cash proceeds of the sale should be characterized as OZBP. Frequently, the amount reinvested will not exactly equal the sales proceeds. As long as an amount equal to the lesser of (1) 100% of the original gain, or (2) 100% of the sales proceeds is reinvested, 100% of the gain, if any, in the replacement QOZBP investment should be exempt from federal income tax after the 10-year holding period is met. If the sales proceeds exceed the original gain as to which a Section 1400Z election is made, and a portion

of the excess sales proceeds is not reinvested, that portion should be subject to current federal income tax, but the reinvested portion should still qualify for 100% gain exclusion at the end of the 10-year holding period.

\* \* \* \*

Thank you very much for your consideration of our comments. We respectfully request the opportunity to meet with you in person to discuss these comments and our concern that future guidance to be issued by Treasury and the Service will bear a prospective effective date. Please let us know about potential dates for such a meeting at your earliest convenience, as we are anxious to commence closing investments into the economically distressed opportunity zones that have been designated under the OZP.