

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

August 15, 2018

RE: Opportunity Zones Regulations (Section 13823 of the Tax Cuts and Jobs Act of 2017)

Dear Acting Commissioner Kautter:

I write on behalf of the National Housing Conference (NHC) to offer comments concerning the implementation of Opportunity Zones (Section 13823) in the Tax Cuts and Jobs Act of 2017.

NHC has been defending the American Home since 1931. We believe everyone in America should have equal opportunity to live in a quality, affordable home in a thriving community. NHC convenes and collaborates with our diverse membership and the broader housing and community development sectors to advance our policy, research and communications initiatives to effect positive change at the federal, state and local levels. Politically diverse and nonpartisan, NHC is a 501(c)3 nonprofit organization.

The Opportunity Zones (OZ) incentive has tremendous potential to attract more investment capital and development talent to revitalize low- and moderate-income census tracts. The OZ incentive allows taxpayers to rollover unrealized capital gains into new equity investments in designated communities. Qualifying equity investments are broadly defined and can include real estate (residential or commercial) or operating businesses. If the taxpayer holds the qualifying investment for ten years, then they can mark-up the investment's tax basis to its new fair market value when sold or exchanged, effectively eliminating any capital gains tax obligation. As a result, the OZ incentive creates its greatest tax benefits for investments with the greatest capital appreciation; more capital appreciation results in more implicit tax benefit.

The OZ incentive's theory of change presumes that ten-year equity investments in low-income communities will yield positive economic outcomes for those communities. Significantly, the OZ incentive does not involve a competitive application process or any targeting to directly benefit low-income people. By comparison, the Low-Income Housing Tax Credit (LIHTC) and the New Markets Tax Credit (NMTC) typically pass through intermediary organizations with a track record of successful and responsive community development. The LIHTC and NMTC entail reporting and governmental oversight to confirm compliance with their income-targeting provisions, which are an important safeguard to ensure that the taxpayer's investment is well spent.

NHC members are concerned about what types of housing will be built with the OZ incentive. Qualified Opportunity Zones are defined based on high poverty rates or low incomes of its residents. According to US Census data, more than half of OZ renters are currently "housing cost-burdened," meaning that they pay over 30 percent of their income towards rent. Among low-income households, the portion of currently housing cost-burdened residents is closer to 80

percent. Will investors use the OZ incentive to build affordable housing for mixed-income communities? Or will the forgiveness of capital gains – with no cap on the increase in the tax basis of the investment – motivate investors to build rental housing with price points that displace current residents? It would be tragic if taxpayers made OZ investments only in higher-priced rental housing, contributing to the elimination of affordable housing that initially qualified the community for OZ designation. This potential unintended consequence could result in displacement and concentrations of poverty contrary to the spirit of the law.

With this context for our comments, we focus on:

- I. How the Department of the Treasury (Treasury) could exercise its statutory authority to define and prevent abuse
- II. Reporting requirements to track the outcomes of the OZ incentive
- III. Guidance and clarification on OZ Businesses to maximize the availability of the OZ incentives to invest in housing, especially affordable housing
- IV. Guidance and clarification on OZ Businesses Property to maximize the availability of the OZ incentives to invest in housing, especially affordable housing
- V. Other Issues
 - A. Clarification that residential multifamily rental housing is an eligible QOZ Business
 - B. Guidance on CRA consideration
 - C. Use of other tax credits in combination with Opportunity Zones
 - D. Infrastructure Investments.

I. Rules to prevent abuse

Discussion

The Opportunity Zone legislation directs the Secretary to “prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including ... (C) rules to prevent abuse.”¹ Until Treasury clarifies the definition of “abuse” and how this authority will be exercised, taxpayers will be cautious in seeking and developing OZ investments. The legislation does not indicate what types of abuse the Secretary should give special attention to, other than what is “necessary or appropriate to carry out the purposes of this section.”²

Anti-abuse provisions in the Code vary significantly, each crafted for a particular subsection in the Code. The American Bar Association’s peer-reviewed tax journal cites a general definition of anti-abuse provisions as rules “designed to prevent a taxpayer from achieving a result which is inconsistent with a dominant policy of the law by altering the tax consequences which would otherwise have flowed from a transaction to others more consistent with that policy.”³ While many anti-abuse rules focus on tax avoidance as a necessary element,⁴ that does not fully capture the

¹ Section 1400Z-2(e)4(C).

² Section 1400Z-2(f) addresses the consequences of a failure of the Qualified Opportunity Fund (QOF) to maintain the ‘90 percent’ investment standard.

³ Frank V. Battle, Jr. *The Appropriateness of Anti-Abuse Rules in the U.S. Income Tax System* 48 TAX LAWYER 801 (1995).

⁴ Another commenter summarized the Code’s anti-abuse provisions as follows:

Many (but by no means all) anti-abuse rules focus on the purpose, motive or intent of the taxpayer in determining whether the anti-abuse rule should apply. Some anti-abuse rules are triggered by a transaction that has as its principal purpose the avoidance of the principles of the applicable provision; some others merely require “a” principal purpose. Some anti-abuse rules explicitly require a finding of

policy violation that should be the focus of anti-abuse rules of OZ incentives. It would be a tragic outcome if OZ investments contributed to the elimination of the affordable housing that initially qualified the community for OZ designation. We are concerned that OZs could unintentionally harm residents without adequate parameters to guard against displacement or prevent predatory capital from becoming an eligible investment. NHC believes that any investments targeted specifically at distressed communities with the purpose of deferring an investor's capital gains taxes must demonstrate a community benefit and demonstrate that it does not displace residents or eliminate affordable housing without a plan for replacement to be eligible for the tax incentive. Changes in the mix of sizes and types of housing or reduction of units should not be considered abuse if supported by market studies and high vacancy in the housing size/units that are changed or eliminated, provided no residents are displaced.

Requested Regulation

Taxpayers and QOFs need clarity on the definition of prohibited abuse.

We suggest that the Secretary issue regulations, as directed by the statute, to define abuse as any investment that does not provide a direct and sustained community benefit to the residents living in the census tract. We recommend that in Opportunity Zones, "abuse" be defined as:

"a partnership, entity, plan, or arrangement that is inconsistent with the purposes of the OZ statute, which seeks to create opportunity in communities where:

(A) the poverty rate for such tract is at least 20 percent, or

(B) (i) in the case of a tract not located within a metropolitan area, the median family income for such tract does not exceed 80 percent of statewide median family income, or

(ii) in the case of a tract located within a metropolitan area, the median family income for such tract does not exceed 80 percent of the greater of statewide median family income or the metropolitan area median family income (AMI).

Subparagraph (B) shall be applied using possession-wide median family income in the case of census tracts located within a possession of the United States.

Penalty for "abuse" - Should a residential development fail to meet these criteria, capital gains must be paid on the percent of the investment not affordable to families above 80 percent of AMI. If the average cost of a unit is not affordable to families under 125 percent of AMI, then the entire development should be excluded from OZ treatment.

Tresury should also eliminate any benefit if the new development displaces residents of housing affordable to households at or below 80 percent of AMI or eliminates any affordable housing and does not replace it with housing affordable at the same or lower income levels in the same or adjacent areas. Benefits should not be eliminated where a market study and high vacancy rates at the property evidence low demand for the eliminated units.

tax avoidance as a principal purpose. Some rules equate a principal purpose of circumventing the underlying purpose of the applicable provision as constituting tax avoidance. *Some require no purpose at all – just a result "inconsistent with the purpose" of the rule at hand.* [emphasis added]

II. Annual Reporting on Investments and Outcomes

Discussion

The Tax Cuts and Jobs Act statute does not describe any reporting requirements, but the Conference Report was explicit about Congressional expectations related to annual reporting requirements:

The Secretary or the Secretary's delegate is *required* to report annually to Congress on the opportunity zone incentives beginning 5 years after the date of enactment. The report *is* to include an assessment of investments held by [the] qualified opportunity fund[s] nationally and at the State level. To the extent the information is available, the report is to include the number of qualified opportunity funds, the amount of assets held in qualified opportunity funds, the composition of qualified opportunity fund investments by asset class, and the percentage of qualified opportunity zone census tracts designated under the provision that have received qualified opportunity fund investments. The report *is* also to include an assessment of the impacts and outcomes of the investments in those areas on economic indicators including job creation, poverty reduction and new business starts, and other metrics as determined by the Secretary.⁵ [*emphasis added*]

Treasury has direct experience collecting and analyzing the type of data necessary for this task: the primary example is the CDFI Fund's operation of the NMTC program in cooperation with the IRS. Every year, the CDFI Fund receives data on the economic outcomes of projects that were funded with qualified NMTC equity investments.⁶ In any given year, the CDFI Fund receives reports on outstanding portfolios of over \$20 billion in NMTC qualified low-income community investments. The Community Investment Impact System (CIIS) is the web-based data collection system that NMTC "allocates" use to submit their Institution Level Reports (ILRs) and Transaction Level Reports (TLRs) to the CDFI Fund. The ILR provides summary organizational, financial, lending and impact data about the institution submitting the report. The TLR provides detailed information on the loans and investments made by the institution in low-income communities.

Treasury also successfully collected data on small business loans and investments enrolled in the State Small Business Credit Initiative (SSBCI) from 2011-17. Treasury's SSBCI program received and analyzed data on more than 21,000 loans and investments exceeding \$10 billion. The annual data collection included census tract location, financing amount, other simultaneous financing, NAICS code, year of incorporation, sales and number of full time equivalent (FTE) jobs.

Treasury has consistently demonstrated the capacity to design a data collection system for a reasonable number of variables in QOFs and QOZ Property with a light touch that will not discourage use of the incentive.

Recommended Annual Reporting Requirements

NHC recommends that the Treasury Department issue a Request for Information (RFI) on the collection of data from Opportunity Funds that are registered with the IRS so that it may prepare a detailed report to Congress as required by the Conference Report. This will allow early adopters of

⁵ Conference Report to Accompany H.R. 1 - Tax Cuts and Jobs Act, p. 539, December 15, 2017.

⁶ The CDFI Fund has allocated \$3.5 billion in NMTC each year since 2010. Allocates report on the outcomes of the qualified low-income community investments for seven years after deployment.

QOFs to be aware of potential reporting requirements and to offer comments on any issues involving collection and reporting. We believe these data points will already be collected as part of any QOF's standard business procedures and that annual reporting to Treasury outside of the procedures for filing tax returns will not be an undue burden. Among the data points for consideration, we recommend:

1. The number of assets held in qualified opportunity funds
2. The composition of qualified opportunity fund investments by asset class of QOZ Property (QOZ stock, QOZ partnership interest, or QOZ business property)
3. The percentage of qualified opportunity zone census tracts designated under the provision that have received qualified opportunity fund investments
4. Date of investment
5. Census tract of QOZ Business Property (for all investments)
6. The dollar amount of the investment in QOZ property
7. The number of rental housing units at the time of acquisition
8. The number of rental housing units in each QOZ property that are affordable to a household earning less than 80 percent of AMI or less than 125 percent of AMI in contiguous tracts before the QOF investment
9. The number of rental housing units in each QOZ property that are affordable to a household earning less than 80 percent of AMI or less than 125 percent of AMI in contiguous tracts 12 months after the QOF investment
10. The number of rental housing units existing in the QOZ Business Property before the QOF investment, after "substantial improvement" is complete
11. The number of housing units in each QOZ property that were sold
12. The number of units sold in each QOZ property that were sold at affordable prices
13. The number of residents displaced by the creation of business in the QOZ
14. The number and location of any replacement units created
15. The number of FTE jobs created within 24 months as the result of the investment.

III. Guidance Requested on Definition of a QOZ Business

Discussion

NHC endorses several comments in the June 18, 2018 letter submitted by the Opportunity Zones Coalition because of their relevance to the development of affordable housing. Developing newly constructed affordable housing involves long planning lead times before equity capital is drawn down from investors to acquire the physical site. In some cases, the legal entity that will ultimately own the real estate project exists during an extended pre-development period. The OZ incentives should accommodate this business model to avoid unnecessary legal re-organizations solely to meet the OZ requirements.

Requested Guidance

Treasury guidance should provide that a newly organized business (including residential real estate projects) that intends to qualify as a QOZ Business by the end of a reasonable start-up period of at least 18 months should be deemed to qualify as a QOZ Business during that start-up period.⁷

⁷ OZ Coalition letter, page 8

IV. Guidance Requested on Definition of QOZ Business Property

Discussion

NHC also endorses the guidance requested on the definition of QOZ Business Property raised in the June 18, 2018 letter submitted by the Opportunity Zones Coalition:

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

The “original use” test has two alternative prongs. It requires that either the original use of [QOZ Business] property in the QOZ commence with the QOF or that the QOF substantially improve the [QOZ Business] property. Congressional intent to stimulate economic activity in distressed communities can be furthered both by encouraging new property to be built or brought into the zone, and by putting existing property to new use within the zone. Just as used property can be brought into the QOZ and have its “original use” in a QOZ Business, vacant property within the QOZ that is purchased or leased by a QOZ Business or QOF should be considered to meet the “original use” test to encourage the use of zone property that is currently under-utilized.

Alternatively, property that is “substantially improved” by the QOF will meet this test. Property will be treated as substantially improved if “during any 30-month period beginning after the date of acquisition of such property, additions to basis with respect to such property in the hands of the qualified opportunity fund exceed an amount equal to the adjusted basis of such property at the beginning of such 30-month period in the hands of the qualified opportunity fund.”

Guidance is needed to provide certainty to QOZ Businesses, QOFs and investors that property which is in the process of substantial improvement qualifies as QOZ Business Property. Otherwise, QOZ Businesses would have to wait until the end of the substantial improvement period, up to two and a half years later, to know whether such property would qualify as QOZ Business Property.

In addition, guidance should clarify how the original use test applies to land within the QOZ, which certainly will have been used before, and how land can qualify as having been substantially improved.

Requested Guidance

“Original use” test. Treasury guidance should provide that if property, including land, is vacant for at least a one-year period, use by a QOF or QOZ Business will be considered “original use” within the QOZ. This is consistent with the definition of original use in the Empowerment Zone context. In addition, guidance should clarify that the period of vacancy should be determined with respect to only that portion of the property acquired by the QOF or QOZ Business, and *de minimis* incidental uses of property should be disregarded. We also suggest that Treasury guidance provide that land on which property is substantially improved shall be treated as substantially improved as well, consistent with the treatment

in the DC Zone context. Finally, Treasury guidance should provide certainty to QOZ Businesses, QOFs and investors that begin to substantially improve property to meet the original use test. Treasury guidance should provide that property will be deemed to qualify as substantially improved during any tax year of the 30-month improvement period if the QOZ Business has a plan to substantially improve the property and the QOZ Business makes reasonable efforts to carry out that plan.⁸

V. Other Issues

A. Eligibility of residential rental housing (Section 1397)

Discussion

Investments in affordable housing are among the most transformative possible investments to stimulate equitable economic development in OZs. The definition of a qualified OZ business cross-references to some (but not all) of the criteria in the definition of an enterprise zone (EZ) business.

Importantly, the OZ statute does not directly reference code section 1397C(d)(2) that excludes residential rental property. In our view, the fact that the drafters chose selectively from the complete list of EZ criteria when defining QOZ Business indicates Congress' intent to allow residential rental property businesses to benefit from QOF investments.

Requested Guidance

NHC recommends that Treasury provide clear guidance affirming that residential rental property businesses qualify as OZ businesses.

B. CRA credit

Discussion

Banks represent a significant class of potential investors in QOFs, and they naturally wonder if investing in a QOF qualifies for favorable consideration under the Community Reinvestment Act (CRA). The revised CRA regulation defines qualified investments as an investment, deposit, membership share or grant that has *community development* as its primary purpose. For CRA, community development encompasses: affordable housing (including multifamily rental housing) for low- and moderate-income individuals; community services targeted to low- and moderate-income individuals; activities that promote economic development by financing small businesses or small farms (gross annual revenues of \$1 million or less); and activities that revitalize or stabilize low- and moderate-income geographies.

The existing guidance to examiners states:

Activities that revitalize or stabilize low- or moderate-income geography are activities that help to attract new, or retain existing, businesses or residents. Examiners will presume that an activity revitalizes or stabilizes a low- or moderate-income geography if the activity has been approved by the governing board of an Enterprise Community or Empowerment Zone (designated pursuant to 26 U.S.C. 1391) and is consistent with the board's strategic plan. They will make the same

⁸ OZ Coalition letter, page 11.

presumption if the activity has received similar official designation as consistent with a Federal, state, local, or tribal government plan for the revitalization or stabilization of the low- or moderate-income geography...

To determine whether other activities revitalize or stabilize a low- or moderate-income geography, examiners will evaluate the activity's actual impact on the geography, if information about this is available. If not, examiners will determine whether the activity is consistent with the community's formal or informal plans for the revitalization and stabilization of the low- or moderate-income geography.⁹

Bank regulators have made clear that not all loans in a low- to moderate-income geography have a stabilizing effect. It seems reasonable that the same analysis would apply to investments.

Some loans may provide only indirect or short-term benefits to low- or moderate-income individuals in a low- or moderate-income geography. These loans are not considered to have a community development purpose. For example, a loan for upper-income housing in a low- or moderate-income area is not considered to have a community development purpose simply because of the indirect benefit to low- or moderate-income persons from construction jobs or the increase in the local tax base that supports enhanced services to low- and moderate-income area residents. On the other hand, a loan for an anchor business in a low- or moderate-income area (or a nearby area) that employs or serves residents of the area and, thus, stabilizes the area, may be considered to have a community development purpose. For example, in a low-income area, a loan for a pharmacy that employs and serves residents of the area promotes community development.¹⁰

Recommendation

NHC is cautious about providing a blanket endorsement that any and all Opportunity Zone investments by banks should be considered favorably. NHC recommends that for purposes of determining whether QOZ investments by regulated banks qualify for favorable CRA consideration, bank regulators should reinforce existing CRA guidance on what constitutes a "community development activity."

C. Availability of other tax credits

The statute does not prohibit investments in a QOZ from also qualifying for other tax incentives, such as the New Markets Tax Credit, the Low-Income Housing Tax Credit, and the Rehabilitation Tax Credit. Indeed, the ability to combine various community development tools to address capital requirements will significantly enhance positive outcomes in low-income communities. Treasury should confirm that these tax credits may also be used in conjunction with QOF investments.

⁹ Federal Register Vol. 81, No. 142, p. 48527 (July 25, 2016).

¹⁰ Federal Register Vol. 81, No. 142, p. 48529 (July 25, 2016).

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D. Infrastructure investments

Investment in new infrastructure, such as water & sewer systems and broadband, that serves a multifamily development should qualify as an Opportunity Zone investment. Especially as this investment supports both housing and other affordable community efforts.

VI. Conclusion

NHC and our members are optimistic that, with the right guardrails, the Opportunity Zones program can successfully direct capital to low-income communities in need of revitalization. Thank you for taking our comments into consideration and we welcome the opportunity to comment on future action surrounding Opportunity Zones. Please contact me at davidmdworkin@nhc.org or 202-442-2121 x234 with any questions.

Sincerely,

A handwritten signature in black ink, reading "David M. Dworkin". The signature is fluid and cursive, with the first name "David" being the most prominent.

David M. Dworkin
President & CEO

Cc:

Dan Kowalski, Counselor to the Secretary, Department of the Treasury

Thomas West, Tax Legislative Counsel, Office of Tax Policy, Department of the Treasury

Michael Novey, Associate Tax Legislative Counsel, Office of Tax Policy, Department of the Treasury