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CERTIFIED PUBLIC ACCOUNTANTS

March 9, 2018

Mr. Scott Dinwiddie
Associate Chief Counsel
Income Tax & Accounting
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

RE Recommendations for Guidance on Opportunity Zones

Dear Mr. Dinwiddie:

On behalf of the members of the Novogradac Opportunity Zones Working Group (the Working Group), we are requesting immediate guidance on various provisions of Internal Revenue Code Section 1400Z-2: Special rules for capital gains invested in opportunity zones by Pub. L No. 115-97. We believe that our guidance recommendations will: help to expedite the implementation of the Opportunity Zones program by the Department of the Treasury (Treasury) and the Internal Revenue Service (IRS); and, provide investors with the information and tools necessary to make informed decisions regarding investment in economically distressed communities.

The guidance requested is listed in order of importance to a successful implementation of the Opportunity Zones program, and included as an attachment to this letter. In particular, there are four areas of main concern.

1. Guidance is needed whether a taxpayer can benefit from the 10 year holding period election to increase investment basis to fair market value when opportunity fund property is sold before a taxpayer sells his/her investment.
2. Guidance is needed on the definition of the "active conduct" of a business for purposes of a qualified opportunity zone business.
3. Guidance is needed on whether an established low-income community business can qualify as a qualified opportunity zone business.
4. Guidance is needed on the meaning of "sale or exchange" for the purpose of the end of the deferral period.

The members of the Working Group are participants in the community development finance field, including investors, lenders, for-profit and nonprofit developers, community development financial institutions, community development entities, and other related professionals. These stakeholders are working together to suggest consensus solutions to technical Opportunity Zone program issues and provide recommendations to make the Opportunity Zones program more efficient in delivering benefits to low-income communities.

We appreciate your consideration of these comments and look forward to the opportunity to discuss these issues further in our meeting scheduled for March 13 at 11:00.

Yours very truly,
Novogradac and Company LLP

By

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Attachments: Recommendations for Guidance on the Opportunity Zones

Recommendations for Guidance on the Opportunity Zones
By Opportunity Zones Working Group
hosted by Novogradac & Company LLP

1. Interim Gains from the Sale of Opportunity Zone Property.

Overview

For purposes of Internal Revenue Code (IRC) §1400Z-2, gains realized on the sale of investments in qualified opportunity funds ("QOFs") that are held for at least 10 years are essentially excluded from gross income, at the election of the taxpayer. More specifically, in the case of the sale or exchange of an investment in a QOF held for more than 10 years, at the election of the taxpayer, the basis of such investment in the hands of the taxpayer shall be the fair market value of the investment at the date of such sale or exchange.[1] Taxpayers can generally recognize losses, if any, from the sale or exchange of investments in QOFs if they do not make the election to have the basis of their investment equal the fair market value on the date the investment is sold or exchanged.

A traditional private equity fund holds and liquidates investments at different times over a number of years and the proceeds from the disposal of each investment are distributed to its investors, or recycled into substitute investments. Under this traditional private equity arrangement, it is unclear how a QOF investor could attain the ten-year benefit of gain exclusion on the sale of qualified opportunity zone property ("QOZP"). This is because any gains realized by a QOF when a fund liquidates investments, will be taxed to the QOF (in the case of a QOF taxed as a C-corporation) or will flow-through and be taxed to QOF investors (in the case of a QOF taxed as a partnership).

Example:

T, a calendar year taxpayer, invested $1 million of gain in P, a QOF partnership, on September 15, 2018 and P makes a $1 million investment in QOZP on the same day. On September 17, 2028, T sells its investment in P for $1.5 million and makes an election to treat its basis in its investment in P as the fair market value of $1.5 million. During the interim, T would have previously increased its basis in its investment in P by $100,000 at the five year mark, and an additional $50,000 at the seven year mark, and further by $850,000 when it recognized the remainder of the deferred income of $850,000 on December 31, 2026. Before the fair market value election, T's basis in P was $1 million, and the fair market value election allows T to further increase its basis in P by $500,000, to $1.5 million. As such, no gain would be included in T's gross income for the tax year ended December 31, 2028 from the sale of T's investment in P.

Assume similar facts as above except that P sells its QOZP for $1.5 million on September 16, 2028 (one day before T sells its investment), in order to have the liquidity necessary to redeem T's investment in P. Under this scenario, P would realize a $500,000 gain on the sale of its QOZP and T recognizes this gain for the tax year ended December 31, 2028.

Recommendation

The Novogradac Opportunity Zones Working Group (the "Working Group") highlights three areas under the special rule for investments held for 10 years that need immediate guidance for taxpayers to be able

[1] §1400Z-2(c)

to assess the benefits of making a long-term investment in a QOF. First, under §1400Z-2(c), clarity is needed on the meaning of the term "such property" within the context of the upward basis adjustments provided for 5, 7 and 10 year investments. Second, if the term, "such property" was intended to be "such investment", taxpayers need relief for situations where a QOF sells appreciated QOZP before a taxpayer sells its interest in the QOF. Finally, relief is needed for gains realized on the sale of appreciated QOZP by a QOF before the end of a taxpayer's 10-year holding period when the proceeds of a sale are reinvested in replacement QOZP within a reasonable period.

Clarity on the meaning of the term "such property" for purposes of property and investments held for 5, 7, and 10 years

Under IRC §1400Z-2(b)(2)(B)(iii), in the case of any investment held for at least 5 years, the basis of **such investment** shall be increased by an amount equal to 10 percent of the amount of gain elected to be deferred.

Under IRC §1400Z-2(b)(2)(B)(iv), In the case of any investment held by the taxpayer for at least 7 years, in addition to any adjustment made under clause (iii), the basis of **such property** shall be increased by an amount equal to 5 percent of the amount of gain elected to be deferred.

Under IRC §1400Z-2(b)(2)(c), In the case of any investment held by the taxpayer for at least 10 years and with respect to which the taxpayer makes an election under this clause, the basis of **such property** shall be equal to the fair market value of such investment on the date that the investment is sold or exchanged.

The 10 percent basis increase provided in IRC §1400Z-2(b)(2)(B)(iii) applies to the basis in the "investment" while the 5 percent basis increase under Code Sec. 1400Z-2(b)(2)(B)(iv) and the fair market value basis increase under IRC §1400Z-2(b)(2)(c) applies to the basis of the "property." Guidance is needed whether all references to basis increases are intended to apply to the basis of the "investment" or the basis of "property", or both. We believe the references should be read to allow both the property and the investment to be adjusted.

If basis adjustments are interpreted to apply to the "investment", then the permanent exclusion election will not protect a taxpayer from recognizing gain when the QOF sells or exchanges QOZP before a taxpayer sells its investment, even if the taxpayer held its investment in the QOF for 10 years. If the basis adjustments are interpreted to apply to QOF "property", then interim sales or exchanges of appreciated property will not result in gain but a taxpayer would realize gain when the proceeds of the sale are distributed to the taxpayer because its investment basis would not be similarly adjusted. If the basis adjustments are meant to apply to both the investment and the QOZP, then taxpayers would be protected from recognizing gain after a 10 year holding period when a QOF sells appreciated property before a taxpayer sells its investment.

Relief in the event "such property" means only "such investment"

If basis adjustments are interpreted to apply to only "such investment", the Working Group recommends that the Department of the Treasury ("Treasury") and Internal Revenue Service (IRS) provide relief for situations where a QOF sells appreciated QOZP before a taxpayer sells its interest in the QOF. Specifically, we recommend that if a taxpayer holds a QOF investment for 10 years and makes an election for the basis of its investment to be its fair market value on the date its investment is sold or exchanged, then the basis of any property owned by the QOF and its investees with respect to the QOF's interest in that property, is similarly adjusted to its fair market value on the date that the property is sold or exchanged.

Continuing with the above example, when T makes an election to treat its basis in P as fair market value on the date its investment is sold or exchanged, then P's basis in its QOZP would equal fair market value when the QOZP is sold or exchanged. As a result, P would have no gain on the sale of its QOZP and T will have no gain included in gross income from the sale of P's QOZP for the tax year ending December 31, 2028. Furthermore, T would not have gain on sale or exchange of its investment in P.

Relief for sales of QOZP before 10 years

The legislative history under IRC §1400Z-2 provides for permanent exclusion of capital gains from the sale or exchange of an investment in the QOF held for at least 10 years[2]. However, it does not appear that the statute protects taxpayers from recognizing gain if a QOF sells appreciated QOZP during a taxpayer's 10-year holding period, even if the QOF reinvests the proceeds in replacement QOZP. In order to be consistent with the legislative history, and therefore the intent of Congress, the Working Group recommends Treasury and IRS allow taxpayers and QOFs (in the case of a QOF taxed as a C-corporation) automatic deferral of any gains realized on the sale or exchange of QOZP that is reinvested in replacement QOZP within a 12 month period. Under this automatic deferral, the taxpayer's adjusted basis of its investment or the QOF basis in its QOZP (in the case of a QOF taxed as a C-corporation) would be lowered by the deferred gain. The deferral period of any interim gain should last until a taxpayer sells its QOF investment. If the QOF investment is held for 10 years, a taxpayer can make the election for permanent exclusion of capital gain provided for in the statute.

Example:

T, a calendar year taxpayer, invested $1 million of gain in P, a QOF partnership, on September 15, 2018 and P makes a $1 million investment in QOZP on the same day. On September 16, 2022 (after 4 years), P sells the QOZP for $1.5 million and reinvests all of the proceeds in replacement QOZP within 12 months. T would recognize a $500,000 gain for the tax year ending December 31, 2022 even though T continues to maintain its investment in P and 100 percent of P's assets are QOZP.

Alternatively, under an automatic deferral of interim gains provision, T would be protected from recognizing the $500,000 gain and P's basis in the replacement QOZP would be $1 million (not the $1.5 million invested in the QOZP).

[2] Opportunity Zones PL 115-97 Conference Report, Senate Amendment

2. Active Conduct of an Opportunity Zone Business

Overview

For purposes of IRC 1400Z-2, in order for an entity in which a QOF invests to be a qualified opportunity zone business ("QOZB"), 50 percent of the total gross income of such entity must be derived from the active conduct of such business.[3] The term "active conduct of such business" is not defined in the statute.

Recommendation

The Working Group recommends that Treasury and IRS provide clarity on the definition of the term "active conduct" by defining what activities constitute "active conduct" under §1400Z-2.

Specifically, the Working Group recommends that Treasury and IRS adopt existing guidance for a similar "active conduct" standard under the new markets tax credit ("NMTC) program[4], whereby an entity will be treated as engaged in the active conduct of a trade or business if, at the time the QOF makes an investment in the entity, the QOF reasonably expects that the entity will generate revenues within 3 years after the date of the investment.

Alternatively, Treasury and IRS could adopt the a more ambiguous standard for "active conduct" found under the Gulf Opportunity Zone program[5], whereby the determination of whether a trade or business is considered actively conducted by the taxpayer is made based on all of the facts and circumstances around whether a taxpayer meaningfully participates (through the activities performed by itself, or by others on behalf of the trade or business) in the management or operations of the trade or business. This less predictable standard will leave much of the judgment to the post investment activity of the business and is likely to discourage investor participation in the program.

Furthermore, we recommend that Treasury and IRS clarify whether the term "such business" requires that 50% of the QOZB total gross income must also be earned in the QOZ, similar to the general place-based requirement under the Enterprise Zone Business statute.[6] The Working Group believes that the OZ program is designed to be place based, and the added complexity of determining the situs of QOZB gross income is not needed. As such, the Working Group recommends that Treasury and IRS confirm

[3] §1400Z-2(d)(3)(A)(ii) by reference to §1397C(b)(2)
[4] Reg. §1.45D-1(d)(4)(iv)
[5] Notice 2006-77 §3.02
[6] The gross income "active conduct" requirement of IRC §1400Z-2 is incorporated by reference to the gross income "active conduct" requirement found in IRC §1397C (b)(2) related to Enterprise Zone Businesses. Under the Enterprise Zone Business statute, there is also a general placed-based business activity requirement found in IRC §1397C (b)(1) whereby the sole trade or business of a qualified entity must be the active conduct of a qualified business within an empowerment zone. IRC §1397C (b)(2) refers back to IRC §1397C (b)(1) by requiring that at least 50% of the entity's total gross income must be from the active conduct of "such business" –such business that has its sole activity in the empowerment zone. IRC §1400Z-2 does not specifically incorporate this general place-based business activity requirement of IRC §1397C (b)(1), it only references the "active conduct of such business" standard of $1397C(b)(2).

that there is not a requirement that 50% of the QOZB total gross income must also be earned in the QOZ.

3. Qualification of Established Businesses as Qualified Opportunity Zone Businesses

Overview

For purposes of IRC 1400Z-2, the term QOZB means a trade or business in which substantially all of the tangible property owned or leased by the taxpayer is qualified opportunity zone business property ("QOZBP").[7] In general. The term QOZBP means tangible property used in a trade or business of the QOF or QOZB if-

- such property was acquired by the QOF by purchase (as defined in section 179(d)(2)) after December 31, 2017,
- the original use of such property in the qualified opportunity zone ("QOZ") commences with the QOF or the OOF substantially improves the property, and
- during substantially all of the QOF's holding period for such property, substantially all of the use of such property was in a QOZ.[8]

An issue confronting established low-income community businesses that existed before January 1, 2018 is that a substantial amount of the business' tangible property is likely to have been purchased or leased before January 1, 2018, thus preventing the business from being a QOZB.

In addition, some established low-income community businesses wishing to expand to QOZs would likely continue to operate a substantial portion of their wider business outside of QOZs. As a result, a substantial portion of the businesses tangible property is likely to be used outside of QOZs making it difficult to comply with the "substantial use test" under the statute that requires substantially all of business' tangible property owned or leased to be used in QOZs.

The exclusion of established low-income community businesses from the benefits of the opportunity zones program is inconsistent with the policy objectives of the opportunity zones program, which is intended to encourage economic growth and investment in distressed communities by providing Federal tax benefits to low-income community businesses located within designated boundaries. There is no legislative history to suggest Congress wanted the opportunity zones program to only benefit new low-income community businesses, and establishing such a requirement would slow and likely reduce the deployment of capital in low-income communities.

Recommendation

The Working Group recommends Treasury and IRS provide the following:

[7] §1400Z-2(d)(3)(A)(i)
[8] §1400Z-2(d)(2)(D)

- Relief to established low-income community businesses that are operating in QOZ but continue to hold a substantial amount of tangible property purchased or leased before January 1, 2018;

- Relief to low-income community businesses wishing to expand to QOZs while continuing operate a substantial portion of their business outside of QOZs by providing for a "portion of a business" rule similar to the rule under the NMTC program.[9] Under this rule, a portion of business would qualify as an QOZB as long as the business would qualify if it was separately incorporated and a complete and separate set of books and records is maintained for that portion of a trade or business to the extent the proceeds of the QOF's investment is used for the portion of the trade or business that is treated as opportunity zone property;

- Clarify the meaning of the term "substantially all. The working group recommends that Treasury and IRS adopt an 70% standard, consistent with the "substantially all" asset standard adopted for qualified asset transfers in tax-free reorganizations under IRC §368;[10]

- Clarify whether "substantially all" is determined by reference to the original cost basis, adjusted tax basis or fair market value of the property held by the entity. The Working Group recommends that Treasury and IRS adopt a two-part standard as follows:

    - For property owned by the QOZB purchased on or before December 31, 2017, the QOZB would use the adjusted tax basis of property as of December 31, 2017 to avoid the added complexity of determining original purchase price or fair market value; and

    - For property owned by the QOZB purchased after December 31, 2017, the QOZB would use the original cost basis.

- Clarify when the tangible property requirement is tested - before or sometime after the QOF's investment in the entity. The working group recommends that Treasury and IRS allow QOZBs a minimum of 12 months following a QOFs investment to meet the tangible property requirement. This will give businesses sufficient time to acquire and put property to use in the QOZ; and

- Clarify that leased property can be QOZBP, even though the acquisition of QOZBP property is required to be by purchase[11] , by adopting the Working Group's recommendation to modify the QOZBP rules to include leased property. For purposes of determining whether a business has sufficient QOZBP, leased property should be valued at a reasonable amount established by the QOZB, which is similar to how leased property is valued under the NMTC program.[12]

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[9] Reg. Sec. 1.45D(1)(D)(4)(iii)
[10] Rev. Proc. 77-37
[11] §1400Z-2(d)(2)(D)(i)(I)
[12] Reg. §1.45D-1(d)(4)(i)(B)(1)

4. Meaning of "Sale or Exchange" for the Purpose of the End of the Deferral Period

Overview

For purposes of IRC §1400Z-2, deferred gains are included in income in the taxable year, which includes the earlier of:

- the date on which the investment is sold or exchanged, or
- December 31, 2026.[13]

Recommendation

The Working Group recommends Treasury and IRS provide clarity:

- That a debt-financed distribution to a QOF partner is not considered a "sale or exchange" for purposes of the end of the deferral period as long as the distribution does not exceed the partner's allocable share of the partnership liability.

  Example

  T, a calendar year taxpayer, invested $5 million of gain in P, a QOF partnership, on September 15, 2018. P used the proceeds from T to construct a building that qualifies as QOZP. On September 15, 2020, building operations stabilize and P pledges the building and borrows $4 million, all of which is allocable to T, and makes a $4 million distribution to T. P's distribution to T does not exceed T's allocable share of partnership liabilities. Therefore, no portion of the $4 million distribution is treated as a "sale or exchange" that ends the deferral period for T.

- In the case of an investment in a partnership QOF, If a partial return of capital (partial redemption) constitutes a "sale or exchange", the Working Group recommends Treasury and IRS to allow taxpayers to use any reasonable method for determining whether a partial redemption has occurred; and

- That end of the deferral period applies proportionately when only a portion of a QOF investment is treated as "sold or exchange".

- That the deferred gain will be taxed in the same manner as it would have been taxed in the year of the sale (e.g., as capital gain from the sale of a business asset, capital gain that constitutes net investment income under §1411, unrecaptured §1250 gain, etc.).

[13] §1400Z-2(b)(1)

5. Use of intangible property in the active conduct of a business

Overview

For purposes of IRC 1400Z-2, in order for an entity to be a QOZB, a substantial portion of the intangible property of such entity must be used in the active conduct of any such business.[14]

Recommendation

The Working Group recommends Treasury and the IRS provide:

- Clarity on the meaning of the term "substantial portion" by adopting a 40% standard consistent with the "substantial portion" standard for tangible property under the NMTC program.[15]

- Clarity on the meaning of the term "used in the active conduct" including examples of what does and does not constitute intangibles used in the active conduct of a business. The working group intends to follow-up with our recommendations on this point; and

- Clarity on whether the term "such business" means that the sole use of the intangible property has to be in the QOZ similar to the general place-base requirement under the Enterprise Zone Business statute.[16] The Working Group believes that the OZ program is designed to be place based with reference to a business' tangible property and the added complexity of determining the situs of intangible property is not needed. As such, the Working Group recommends that Treasury and IRS confirm that there is not a requirement that a QOZB needs to determine where its intangible property is being used.

6. 90 Percent Requirement for Opportunity Funds

Overview

For purposes of IRC §1400Z-2, a QOF is required to hold 90 percent of its assets in QOZP, determined by the average of the percentage of QOZP held in the fund as measured:

- on the last day of the first 6-month period of the taxable year of the fund, and

[14] §1400Z-2(d)(3)(A)(ii) by reference to §1397C(b)(4)
[15] Reg. §1.45D-1(d)(4)(i)(B)(1)
[16] The "active conduct" requirement for the use of intangible property of IRC §1400Z-2 is incorporated by reference to the active conduct standard found in IRC §1397C (b)(4) related to Enterprise Zone Businesses. Under the Enterprise Zone Business statute, there is a general placed-based business activity standard found in IRC §1397C (b)(1) whereby the sole trade or business of a qualified entity must be the active conduct of a qualified business within an empowerment zone. IRC §1397C (b)(4) refers back to IRC §1397C (b)(1) by requiring that a substantial portion of the intangible property of such entity be used in the active conduct of any "such business" – such business that has its sole activity in the empowerment zone. IRC §1400Z-2 does not specifically incorporate this place-based activity standard of IRC §1397C (b)(1), it only references the "active conduct of such business" standard of $1397C(b)(4).

- on the last day of the taxable year of the fund.[17]

Recommendation

The Working Group recommends that Treasury and IRS provide:

- a grace period for making initial investments, similar to the NMTC tax credit program,[18] whereby a taxpayer's cash investment received by the QOF is treated as invested in QOZP to the extent that the cash is so invested within the 12-month period beginning on the date the cash is received by QOF;

- a grace period for making reinvestments, similar to the NMTC tax credit program,[19] whereby amounts received by an QOF in payment of, or for, capital or equity with respect to an QOZP investment are treated as continually invested in QOZP if reinvested by the QOF in QOZP no later than 12 months from the date of receipt;

- clarity on which dates an QOF would use to compute the 90 percent requirement during a short taxable year. In the event that the first taxable year is a short taxable year, the Working Group recommends, IRS and Treasury provide a 12-month grace period (discussed above), whereby a taxpayer's cash investment received by the QOF is treated as invested in QOZP to the extent that the cash is so invested within the 12-month period beginning on the date the cash is received by the QOF;

- clarity that the 90 percent requirement is to be determined by reference to the original cost basis, and not adjusted tax basis, fair market value, or other reporting of QOZP held by the QOF.

- clarity on how to determine a monthly penalty for failing to meet the 90 percent requirement when the 90 percent requirement is determined on an annual basis.[20] The working group intends to follow-up with our recommendations on this point; and

- a special rule for reserves, similar to the NMTC program[21], whereby reserves not in excess of 5 percent of an QOF’s assets maintained by the QOF are treated as invested in QOZBP.

[17] §1400Z-2(d)(1)
[18] Reg. §1.45D-1(c)(5)(iv)
[19] Reg. §1.45D-1(d)(2)(i)

[20] §1400Z-2(f)
[21] Reg. §1.45D-1(d)(3)

7. Nonqualified Financial Property

Overview

For purposes of IRC §1400Z-2, less than 5 percent of the average of the aggregate unadjusted bases of the property of a QOZB must be attributable to nonqualified financial property.[22]

Nonqualified financial property means debt, stock, partnership interests, options, futures contracts, forward contracts, warrants, notional principal contracts, annuities, and other similar property specified in regulations; except that such term shall not include reasonable amounts of working capital held in cash, cash equivalents, or debt instruments with a term of 18 months or less, or debt instruments described in section 1221(a)(4).[23]

Recommendation

The Working Group recommends Treasury and the IRS to provide a rule, similar to the NMTC program[24], whereby cash held by a QOZB that will be expended for construction of real property within 12 months be treated as a reasonable amount of working capital.

8. Reasonable Expectation Safe Harbor

Overview

For purposes of IRC §1400Z-2 corporations and partnerships must be QOZBs or in the case of newly established entities being organized for purposes of being QOZBs, at the time the QOF investment is made to be considered QOZP.[25] Furthermore, during substantially all of the QOF's holding period for such investment, the entity must qualify as a qualified opportunity zone business.[26]

Recommendation

The Working Group recommends Treasury and IRS provide clarification on what is meant by the term “substantially all” of the QOF’s holding period. The Working Group recommends an 85% standard here consistent with the NMTC program.

Furthermore, a reasonable expectation safe harbor should be provided, similar to the NMTC program.[27] Under this similar safe harbor, a trade or business would be treated as an QOZB for the duration of an QOF’s investment if the QOF reasonably expects at the time the fund makes its investment that the

[22] §1400Z-2(d)(3)(A)(ii) by reference to §1397C(b)(8)
[23] §1397C(e)
[24] Reg. §1.45D-1(d)(4)(i)(E)(2)
[25] §1400Z-2(d)(2)(B)(i)(II) and §1400Z-2(d)(2)(C)(ii)
[26] §1400Z-2(d)(2)(B)(i)(III) and §1400Z-2(d)(2)(C)(iii)
[27] Reg. §1.45D-1(d)(6)

entity will satisfy the requirements to be a QOZB throughout the entire period of the investment. This safe harbor will provide more certainty to taxpayers, enhancing the effectiveness of the program. Without such a safe harbor, many potential QOF investors may choose not to invest, reducing the amount of capital deployed in QOZs.

9. Basis adjustments for investments held for 5 and 7 years

Overview

For purposes of IRC §1400Z-2, in the case of any investment held for at least 5 years, the basis of such investment shall be increased by an amount equal to 10 percent of the amount of the gain deferred[28] and in the case of any investment held by the taxpayer for at least 7 years the basis of such property shall be increased by an additional 5 percent of the amount of gain.[29]

Recommendation

The Working Group recommends Treasury and the IRS to provide clarification that a taxpayer is eligible for the 10 percent and 5 percent basis adjustments when the end of the five or seven year holding period follows the December 31, 2026 required deferred tax payment date.

10. Bridging Opportunity Fund Investments in Opportunity Zone Property with Debt

Overview

For purposes of IRC §1400Z-2, gross income for the taxable year shall not include so much of such gain as does not exceed the aggregate amount invested by the taxpayer in a QOF during the 180-day period beginning on the date of such sale or exchange.[30]

The term QOF means any investment vehicle which is organized as a corporation or a partnership for the purpose of investing in QOZP (other than another QOF) that holds at least 90 percent of its assets in QOZP, determined by the average of the percentage of QOZP held in the fund as measured on the last day of the first 6-month period of the taxable year of the fund, and on the last day of the taxable year of the fund.[31]

Recommendation

The Working Group recommends Treasury and the IRS to provide clarification that a taxpayer qualifies for tax deferral if the proceeds from the taxpayer's QOF investment are used to repay a loan borrowed by the QOF to invest in QOZP.

[28] §1400Z-2(b)(2)(B)(iii)
[29] §1400Z-2(b)(2)(B)(iv)
[30] §1400Z-2(a)(a)(A)
[31] §1400Z-2(d)(1)

Example

P, a QOF partnership, borrowed $1 million on September 15, 2018 and invested the proceeds in QOZP on the same day. On December 31, 2018, T, a calendar year taxpayer, invested $1 million of gain from a sale of property (within a 180-day period of the sale) in P. P used the proceeds from T's investment to repay the $1 million debt.

Based on the above example, The Working Group recommends Treasury and the IRS to provide clarification that T qualifies for tax deferral even though the proceeds of T's investment are not directly traced to the QOFs investment in QOZP.

11. Correction of Drafting Errors

The Working Group also wants to bring your attention to the following clerical errors in the statute:

- IRC §1400Z-2(b)(2)(B)(ii): the term "such property" should be "such investment"
- IRC §1400Z-2(c): the term "such property" should be "such investment" or vice versa.
- IRC §1400Z-2(d)(2)(D)(ii): the reference to "(A)(ii)" should be "(D)(i)(II)"
- IRC §1400Z-2(d)(2)(D)(iii): the reference to "(A)(i)" should be "(D)(i)(I)" and the reference to paragraph (8) should be "subsection (e)(2)"
- IRC §1400Z-2(f)(1) – the reference to subsection (c)(1) should instead be to (d)(1)