The Real Estate Roundtable

December 19, 2018

The Honorable David J. Kautter
Assistant Secretary of Tax Policy
U.S. Department of Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable William M. Paul
Chief Counsel (Acting)
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Guidance Regarding Opportunity Zones

Dear Assistant Secretary Kautter and Chief Counsel Paul:

On behalf of The Real Estate Roundtable, I am pleased to provide comments regarding the Opportunity Zone legislation and the recently proposed Treasury regulations (REG-115420-18). The proposed rules are an important step forward and create a powerful incentive to spur economic development in low-income communities. Real estate development and redevelopment is a key component of any region's economic strength and growth, and the final regulations should further encourage productive, job-creating real estate investment in the designated areas. We recommend that the final regulations build on the strong foundation laid by Treasury and the IRS in the proposed regulations by addressing five key issues:

1. Removing barriers to the formation of multi-asset opportunity funds through flexible exit rules;

2. Clarifying the circumstances in which land and previously vacant buildings constitute qualified opportunity zone business property;

3. Allowing appropriate refinancing of opportunity fund assets and avoiding overly restrictive debt-distribution rules;

4. Encouraging continued investment in opportunity zones with flexible gain reinvestment, roll-over, and holding period rules at the investor, fund, and business level; and

5. Providing additional protections in the working capital safe harbor and the substantial improvement rules for taxpayers making a good faith effort to comply with opportunity zone requirements.

Each of these issues is addressed in detail below.

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1. Remove barriers to the formation of multi-asset opportunity funds through flexible exit rules

Investors want the ability to invest in opportunity funds that can spread risk by owning a broad range of properties and businesses in low-income communities. Under the proposed rules, a qualified opportunity fund (QOF) with multiple business holdings could not sell assets individually and allow investors to capture the tax benefit (the exclusion of gain) on the fund's appreciation with respect to the assets sold. In contrast, a typical real estate fund will invest in several properties, and the fund manager may dispose of properties one by one, passing the benefits on to its investors sale by sale. The ability to sell properties individually maximizes the value of fund assets in the marketplace, thus making the fund more attractive to potential investors.

Section 1400Z-2(c) requires the sale of an interest in a QOF ("Fund Interest Sale Requirement") to obtain the 10-year basis step-up for investors. Under section 1400Z-2 and the proposed regulations, the basis step-up and consequent gain exclusion would not apply to the sale of a single asset by a multi-asset fund (subject to the discussion below regarding corporate liquidations), even if all the investors held their interests in the fund for at least 10 years. The restrictive exit requirements that apply to multi-asset opportunity funds thus impede their ability to attract and pool capital for investment.

To address these concerns, we recommend that the final regulations include at least one of the following options:

a. <u>Extend the partnership division concept to QOFs by allowing a QOF to divide into multiple QOFs and permitting the spin-off of a single property held in a multi-property QOF to a QOF with only one asset</u>. This modification would allow a QOF to freely dispose of the interests in the QOF holding a single asset if the purchaser wanted to acquire only that asset;

b. <u>Permit the sale of tracking interests in a QOF that track the performance of a specific property</u>. The sale of the tracking interest would be treated as the partial sale of an interest in a QOF, allowing existing investors who have held an interest in the QOF for 10 years to capture the tax benefit (the exclusion of gain) with respect to appreciation on such property, despite the subsequent distribution of the underlying property (or interests in the special purpose entity owning the property) to the purchaser of the tracking interests; or

c. <u>Allow a basis step-up in property inside a property subsidiary of a QOF upon a sale of such property if the partner in the QOF has held its interest for 10 years</u>. The effect would be similar to a section 754 adjustment for eligible partners who meet the 10-year requirement. The rule would treat a distribution by the QOF of the proceeds of the sale of the property inside the QOF as the partial sale of an interest in the QOF. As a result, the investor receiving the distribution would meet the Fund Interest Sale Requirement, and would benefit from the 10-year basis step-up in its interest in the QOF.

d. <u>Permit the use of intermediary entities, such as so-called "feeder funds", that aggregate deferred capital gain from taxpayers and then, in turn, invest in one or more QOFs</u>. This solution would provide scalability and allow fund managers to operate similar to a traditional real estate fund. Nothing in section 1400Z-2 specifies that a taxpayer must invest *directly* in a QOF, as opposed to indirectly through an intermediary feeder partnership. Rather, the

> requirements of the statute are that the taxpayer must: (1) have eligible gain, and (2) invest the gain in a QOF during the applicable 180-day period following recognition of the gain. Treasury has previously issued regulations under section 1045 that expressly allow the use of an intermediate partnership to acquire property in order to defer gain under an analogous statutory scheme. *See* Treas. Reg. § 1.1045-1(a).

Authorizing the use of one or more of the options described above would unlock capital for investment in low-income communities by addressing the exit issue confronting multi-asset opportunity funds, and would do so in a manner that is consistent with the statutory requirements of section 1400Z-2.

2. Clarify the circumstances in which land and previously vacant buildings constitute qualified opportunity zone business property

Treatment of land. Final regulations should confirm that land is qualified opportunity zone business property provided the building built on the land is qualified opportunity zone business property. The final regulations should not treat land as disqualified property for purposes of the 90 percent opportunity fund asset test and the 70 percent opportunity zone business test simply because it was acquired by an entity before January 1, 2018 or it was acquired from a related party. As long as a major investment is undertaken prospectively (in the form of new construction or a substantial improvement of the property), it should not matter whether the owner of the underlying land is (a) a new and unrelated party, (b) an investor related to the prior owner, or (c) a long-time owner of the property. The proposed regulations and accompanying guidance already distinguish between land and structure for purposes of the substantial improvement test—a distinction that is appropriate since land, even when acquired from an unrelated taxpayer after December 31, 2017, can never satisfy the original use requirement. Moreover, unlike other tangible assets, taxpayers generally do not seek to increase the tax basis of tangible property through substantial land improvements. Rather, the real estate is put to productive use through new construction or substantial improvements to buildings located on the land. Treating land as qualified property provided the QOF is constructing new or substantially improved structures on the land will encourage the development and modernization of otherwise languishing real estate located in opportunity zones.

To prevent potential abuse, the regulations could include a requirement that improvements to buildings located on the land exceed two times the value of the land in order for the land to qualify as opportunity zone business property. The rule would ensure that a property owner could not build a shack or other inexpensive structure on a parcel of land solely for the purpose of treating the land as qualifying property.

Alternatively, the regulations could clarify that the nondepreciable land underlying a qualifying structure is neither “good” or “bad” property for opportunity zone purposes, but excluded from the 90 percent and 70 percent asset tests altogether. We believe a flexible approach to how the final regulations treat the acquisition and ownership of land will be a key factor in opportunity zones’ ability to attract capital and jobs to low-income communities.

Original use requirement. The regulations should also provide an 80-20 rule that clarifies that if a property owner improves an existing structure, and the value of the structure before the improvements is 20 percent or less than the value after the improvements, the improved structure will be deemed to meet the original use requirement of the opportunity zone statute. Existing tax law supports treating tangible personal property as placed in service anew provided the retained (or used) component property is valued at less than 20 percent of the value of refurbished property. *See* Rev. Rul. 68-111, 1968-1 C.B. 29 (holding that a railroad locomotive was new section 38 property where the cost of used materials and parts was not more than 20 percent of the total cost of materials and parts used in constructing it) and Rev. Rul. 94-31, 1994-1 C.B. 16 (holding that a wind facility qualifies as originally placed in service even though it contains some used property, provided the fair market value of the used property is not more than 20 percent of the facility's total value (the cost of the new property plus the value of the used property).

Final regulations should make clear that this 80-20 rule applies in the context of substantial improvements made to buildings where such additions to the basis of existing structures are four times greater than the value of the of the used or retained components. This will encourage even greater investment to repurpose and refurbish existing buildings located in an opportunity zone without first requiring the sale of such property to an unrelated party. Application of the 80-20 rule also would eliminate the need for a pre-2018 property owner in an opportunity zone to tear down an existing structure in order for its replacement structure to qualify as opportunity zone business property.

The final rules should also clarify that a building located in an opportunity zone, if vacant for one year or more, is treated as put to its original use when it is placed in service by an opportunity fund. The purpose of opportunity zones is to spur jobs and economic growth in underserved communities. Putting vacant buildings back in service revitalizes surrounding areas and strengthens communities. Such activities will always involve some level of new investment in the structure, even if it does not meet the doubling of basis required to comply with the substantial improvement test.

3. Allow appropriate refinancing of opportunity fund assets and avoid overly restrictive debt-distribution rules

In order for opportunity funds to attract the capital needed to spur economic growth in low-income communities, investors need assurance that the funds will not be subject to overly restrictive limits on traditional and customary refinancing transactions. Debt distribution rules that result in gain recognition, loss of QOF status, loss of the 5-year and 7-year basis step-ups, or loss of the 10-year basis step-up, would negatively impact capital formation and the success of the opportunity zone program.

Final regulations should clarify that QOFs can refinance opportunity zone assets and distribute proceeds without triggering recognition of the deferred gain, provided the refinancing does not reduce the fair value of equity in the QOF interest below the level of the original deferred capital gain. The rules should permit refinancing on the increase in value of the deferred gain contribution (with an administrative safe harbor for growth supported by a third-party appraisal). A distribution, however, would be subject to the general rules of Subchapters C and K, as the case may be. A partnership should be permitted (or required) to revalue its capital accounts under Treasury Regulation section 1.704-1(b)(2)(iv)(*f*) to properly reflect the economics of such a refinancing and distribution. A rule that requires QOFs to retain equity value equal to the initial deferred amount would represent a balanced approach—ensuring the program leads to long-term, patient investment in low-income communities while also allowing opportunity funds to compete for capital with traditional real estate funds that are not subject to debt distribution restrictions.

At a minimum, the final rules should allow refinancing distributions to facilitate investors' payment of deferred capital gains tax due at the end of 2026. The lock-up of capital gain in a QOF without the clear ability to receive a distribution from the QOF when the tax is owed at the end of 2026 is a significant disincentive to investment in opportunity funds.

We encourage Treasury to reject any rule that would limit debt distributions to operating income or net earnings. Such a rule would make opportunity funds significantly less attractive to prospective investors than traditional real estate funds and reduce the potential for opportunity zones to have a transformative impact on low-income communities.

4. Encourage investment in opportunity zones with flexible gain reinvestment, roll-over, and holding period rules at the investor, fund, and business level

In the proposed regulations, Treasury indicated or implied that it would address gain reinvestment, roll-over, and holding period issues in forthcoming guidance. Treasury has ample authority to address these subjects in a manner that would spur greater investment.

<u>Tacking of holding period</u>. First, the final regulations should clarify that if an investor sells its QOF interest and reinvests in another QOF within 12 months of the sale, the investor is allowed to tack on the investor's holding period of the old investment for purposes of the five, seven, and 10-year rules for the new investment. Here, the key point is that the investor's capital remains committed to opportunity zone investment. This is consistent with the proposed rule deferring gain recognition when an investor sells a QOF interest and reinvests in another QOF.

<u>Sale of property/reinvestment of proceeds by a QOF</u>. Second, the final regulations should provide reinvestment rules that allow sales of property owned by a QOF without recognition of gain at the fund or investor level, provided the QOF reinvests in qualifying opportunity zone property within 12 months. A similar 12-month rule applies for purposes of the new markets tax credit. In addition, the sale and reinvestment by the QOF should not affect the holding period for the investor's QOF interest.

Flexible reinvestment rules will contribute to a more efficient market, with capital flowing to its best use, and will encourage investors and funds to remain committed and invested in the designated communities.

5. Provide additional protections in the working capital safe harbor and the substantial improvement timetable for taxpayers making a good faith effort to comply with opportunity zone requirements

The proposed rules requested comments on the adequacy of the 31-month working capital safe harbor, ancillary safe harbors that protect a business during the working capital period, and whether there is a statutory basis for any additional relief. The proposed working capital safe harbor is a major, positive development in the rulemaking that will allow opportunity funds (particularly, single-asset funds) to move forward with meaningful real estate projects in low-income communities. However, notwithstanding the proposed safe harbor, the 90 percent asset test will continue to present major challenges for funds that seek to raise and pool blind capital for diversified investments without identifying specific projects in advance. Thirty-one months is a short and challenging period for large-scale, ground-up real estate development, even once a QOF has identified a specific property for improvement. Yet, many funds may seek to raise capital prior to identifying all intended investments. Unforeseen delays related to zoning, permitting, and other factors often cause well-intentioned projects to take longer than anticipated. In order to encourage the pooling of blind capital from diverse sources for broad-based, diversified opportunity funds, the final rules should provide taxpayers with additional flexibility. Fortunately, Treasury has ample statutory authority to do so in the grant of regulatory authority found in section 1400Z-2(e)(4)(A).

Time extensions for unforeseeable delays. Final regulations should clarify that, notwithstanding the 31-month working capital safe harbor and 30-month substantial improvement period, taxpayers can extend these periods due to extenuating circumstances outside the taxpayer's control. The IRS and Treasury have provided such relief in the energy credit area under section 45, which take into account a taxpayer's continuous efforts to complete construction of a qualifying energy facility based on the relevant facts and circumstances. Under the guidance, a taxpayer can still satisfy the continuous efforts requirement if there are certain disruptions that are beyond the taxpayer's control that affect the continuity of the construction. Examples of such disruptions include: severe weather, natural disasters, licensing and permitting delays, labor stoppages, financing delays of less than six months, delays caused by federal or state agencies, supply shortages, the presence of endangered species, and the inability to acquire specialized equipment. IRS Notice 2013-29. Allowing an extension of these periods due to unforeseeable or unanticipated factors would promote greater investment and economic development in opportunity zones by removing a major source of tax risk and investor uncertainty. Such guidance would recognize the real world realities of complex real estate projects while allowing opportunity zone investors to move forward, in good faith, with major investments in low-income communities.

In addition, the final regulations should clarify that the working capital safe harbor also extends to a QOF, not just a qualified opportunity zone business. Limiting the working capital safe harbor to lower-tier entities will force complex and unnecessary tax structuring that serves no recognizable policy purpose. Providing a working capital safe harbor at the fund level will facilitate the pooling of capital from diverse sources for investment in opportunity zones.

We also recommend that Treasury clarify that the working capital safe harbor applies to all projects expected to qualify as an opportunity zone business, whether the schedule begins with the purchase or other acquisition of non-qualifying land (*e.g.*, land acquired from a related person or contributed to an entity operating the opportunity zone business). As such, the final regulations should clarify that such land does not prevent the opportunity zone business from qualifying during the 31-month safe harbor period.

Lastly, we recommend that Treasury clarify proposed regulation section 1.1400Z-2(d)(5)(iv)(C) to allow a QOF to make reasonable changes (consistent with the development of real estate projects) to a written plan described in paragraphs (d)(5)(iv)(A) and (B). The clarification would recognize that complex challenges and uncertainties inevitably arise when developing large real estate projects – including those related to zoning, regulatory, and environmental issues – and taxpayers need flexibility to make necessary adjustments.

Additional issues:

- **Reporting requirements**. The conference report directs Treasury to report annually to Congress on the opportunity zone incentives beginning five years after enactment. In addition to assessing the impact of investments on job creation, poverty reduction, and new business starts, as provided in the legislative history, we encourage Treasury to consider the aggregate impact of investments on the overall health and wellbeing of targeted communities. A thorough assessment of opportunity zone investments should consider their impact on: (a) the local tax base and its capacity to finance critical public needs, such as education and public safety; (b) the surrounding infrastructure, such as investment in roads and public transit; and (c) economic opportunity and the ability to attract and retain small businesses and other employers. For example, new real estate development creates both temporary and permanent jobs, while also creating the built spaces and surrounding infrastructure needed to attract start-ups, small businesses, and employers of all sizes to a community.

- **Community Reinvestment Act**. We encourage the Treasury Department to work with federal agencies to coordinate and harmonize opportunity zone incentives with other regulatory regimes that encourage investment in low-income communities. Guidance under the *Community Reinvestment Act*, for example, provides that federal agencies will presume that certain investments in new markets tax credit-eligible community development entities are community development activities that promote economic development. *See* Interagency Questions and Answers Regarding Community Reinvestment § __.12(g)(3) – 1 (2016), 81 Fed. Reg. 48505, 48526 (July 25, 2016). Treasury should work with the Federal Reserve Board of Governors and the Federal Deposit Insurance Corporation to issue similar guidance clarifying that an opportunity zone investment presumptively qualifies for credit under the *Community Reinvestment Act*.

- **Partnership liabilities and gain eligible for exclusion**. Treasury regulations should clarify that all gain (including gain attributable to depreciation and losses allocated over the holding period) is excluded upon the sale of the QOF interest, not just the post-investment appreciation. Under Treas. Reg. § 1.1001-2(c), the amount realized on a sale of the QOF partnership interest includes the selling QOF member's share of the QOF's liabilities. The step-up to fair market value (FMV) after 10 years presumably excludes a partner's share of partnership debt and arguably creates a gain equal to the selling QOF member's share of the QOF's liabilities.

  For example, assume an individual invests $100 of eligible capital gain into a QOF, which then borrows $200 and develops an asset with the $300. The investor receives losses (including depreciation deductions) of $250 over a 10+ year holding period, at which time the interest is worth $600 (net of the $200 liability). The investor is treated as receiving proceeds of $800 ($600 FMV + $200 Relief of Liability) and has a basis of $50 (negative tax capital of $150 + $200 liabilities), for a realized gain of $750. It is not clear under the proposed regulations whether the investor would be entitled to increase in basis to its net FMV, which is $600, or its gross FMV, which is $800. If only $600, the investor would be treated as receiving $800 of proceeds and arguably would be required to recognize $200 of gain (*i.e.*, the amount of the liabilities allocated to investor). Such result is inconsistent with the legislative intent to exclude all gain when an investor sells his or her QOF interest after 10 years. If clarified to be net FMV, it may lead taxpayers to avoid investing in QOFs structured as partnerships.

- **<u>Deferral of section 1231 gain</u>**. The proposed regulations define gain eligible for deferral in a QOF as gain that "is treated as capital gain for federal income tax purposes." Section 1231 governs the tax treatment of gain on the sale or exchange of non-inventory depreciable and real property held for more than one year and used in a trade or business. To the extent that section 1231 gains offset section 1231 losses (including non-recaptured net section 1231 losses for the preceding five taxable years), such gain is treated as capital gain for tax purposes. The determination of whether section 1231 gain is capital gain is made at the partner, rather than partnership, level. As a result, the regulations may prevent partnerships from deferring recognition of section 1231 gain through a direct investment of the gain by the partnership in a QOF.

  Moreover, the majority of publicly traded REITs utilize the umbrella partnership (UPREIT) structure. In the UPREIT structure, the REIT owns a majority interest in an operating partnership (OP), and the OP owns and operates real property. Outside investors own the remaining OP interests. Generally, the UPREIT structure precludes the REIT partner from making an investment outside the OP unless it is contributed subsequently to the OP. An investment of the REIT partner's allocable section 1231 gain of the OP in a QOF, followed by a contribution of the QOF interest to the OP, may trigger taxation of the deferred gain. Similar to the former District of Columbia section 1400B tax incentive, and in order to promote capital investment in opportunity zones, Treasury should modify the proposed regulations to clarify that eligible gain includes gain from the sale or exchange of a capital asset or property used in the trade or business (as defined in section 1231(b)). *See* I.R.C. § 1400B(e)(1).

- **<u>REIT capital gain dividends and the 180-day deferral period</u>**. Generally, under the proposed regulations, a taxpayer has 180 days from the date of gain recognition to defer the gain by investing in a QOF. An example in the regulations indicates that the 180-day time period for REIT shareholders to invest capital gain dividends begins at the time the dividend is paid. However, a REIT may only declare a capital gain dividend on its net capital gain, and there is generally no way for a REIT to determine if a dividend will be eligible until the end of the taxable year (when the REIT aggregates all of its gains and losses). Moreover, a REIT dividend is not treated as a capital gain dividend unless it is designated as a capital gain dividend by the REIT, which can occur up to 30 days after the close of the REIT's tax year. As a result, the REIT shareholder may not know whether the distribution is taxable as ordinary income, a return of capital, or a capital gain dividend until this time. Left unchanged, a significant share of REIT capital gain distributions could be ineligible altogether for investment in opportunity zones. An additional amount of REIT capital gain distributions would be subject to a deferral period that is significantly shorter than the intended 180 days. To address these concerns and promote investment in opportunity zones, the final regulations should clarify that the 180-day period for deferral and reinvestment of a REIT capital gain dividend in a QOF begins on the date that is 30 days after the end of the REIT's taxable year.

- **Active conduct test**. We recommend that the final regulations implement the opportunity zone active trade or business requirement in a manner similar to new markets tax credit (NMTC) active conduct test. An opportunity zone business must derive at least 50 percent of its total gross income from an active trade or business. A nearly identical requirement applies to a "qualified active low-income community business" eligible for tax-preferred investments under the NMTC. I.R.C. § 45D(d)(2)(A)(i). Under Treasury regulations implementing the NMTC active conduct test, an entity is treated as engaged in the active conduct of a trade or business if, at the time of investment in the entity, the investor "reasonably expects that the entity will generate revenues . . . within 3 years after the date the investment or loan is made." Treas. Reg. § 1.45D-1(d)(4)(iv)(A). An accompanying example refers to an investment in an entity that will own and operate a shopping center to be constructed in a low-income community. The entity has no revenues, but the investor reasonable expects that it will generate revenues 18 months in the future. The business is treated as engaged in the active conduct of a trade or business of purposes of the NMTC active conduct test. Application of the NMTC standard would eliminate the need for a new and complicated test, and would eliminate a potential source of uncertainty that could deter investment.

- **Self-constructed property**. Self-constructed property should be deemed to satisfy the requirement that qualified opportunity zone business property be acquired by purchase (as defined in section 179(d)(2)) after December 31, 2017 provided the QOF or qualified opportunity zone business acquiring the property began manufacturing, constructing or producing the property after December 31, 2017. For this purpose, Treasury should rely on the acquisition date definition for self-constructed property under former section 168(k)(2)(A)(iii)(II), which provides that if the construction of property begins after the required acquisition date, then such property may be qualified property even if there was a written binding contract in place to construct the property before the required acquisition date. *See* Treas. Reg. § 1.168(k)-1(b)(4)(iii).[1]

  The regulations also define when construction begins. Construction of qualified property begins when physical work of a significant nature begins. Physical work does not include preliminary activities such as planning or designing, securing financing, exploring, or researching. The determination of when physical work of a significant nature has begun depends on the facts and circumstances. The regulations, however, provide a safe harbor that physical work of a significant nature has begun when the taxpayer incurs or pays more than 10 percent of the total cost of the property (excluding the cost of any land and preliminary activities).[2]

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[1] Under these rules, property that is manufactured, constructed, or produced for the taxpayer by another person under a written binding contract that is entered into before the manufacture, construction, or production of the property begins is considered to be manufactured, constructed, or produced by the taxpayer.

[2] The preamble to the regulations acknowledges the hard cut-off date in the statute, but provides that for self-constructed property (including self-constructed property constructed by another person under a written binding contract), the property still may be qualified property if construction begins pursuant to such contract after the applicable acquisition date, regardless of whether the contract was in existence on or before the applicable date.

- **<u>Basis issues</u>** – The final regulations should clarify that customary section 752 and 704 rules apply to QOFs and their investors. For example, the regulations should provide that:

    - The section 752 basis rules are not modified and apply to a QOF and subsidiaries as they would with any other partnership under sub-chapter K, so that non-recourse debt and non-recourse allocations are allocated among the partners of a QOF and subsidiaries as currently provided in Subchapter, and

    - The respective deferred gain contribution percentage to a QOF of each partner of a QOF and subsidiaries is treated as a permissible significant partnership item percentage that can be used for allocating non-recourse deductions under Treas. Reg. 1.704-2(e)(2) in that same ratio.

- **<u>Transfers of units</u>** – The final regulations should clarify the following with respect to transfers of interests in a QOF:

    - If received in a non-recognition transaction, the transferee of the QOZ interest stands in the shoes of the transferor and may receive QOZ benefits (a step up in basis after five, seven, or 10 years using the holding period of the transferor),

    - If received in a taxable sale of a QOF fund interest, the purchaser should be eligible upon the QOF's making a section 754 election to step up the Purchaser's share of the QOF's basis in its property under section 743(b), as with any traditional partnership. The Purchaser having not deferred its gain under section 1400Z-2(a) would not be eligible for the step up after five, seven, or 10 years. That should not preclude the purchaser from stepping up its share of the QOF's assets,

    - Similarly, if the QOF makes a distribution in excess of basis in full or partial redemption of a partner's interest, the QOF should be eligible to make a section 754 election and step up the basis of its assets under section 734(b). Appropriate adjustments would be required to account for those partners eligible to step up their basis in the QOF after five, seven, or 10 years so as not to create an artificial loss, and

    - The regulations should provide that customary basis step-up rules at death apply.

- **<u>Capital gain netting</u>** – The final regulations should clarify that:

    - An investment of capital gain is eligible if the taxpayer has both capital gains and capital losses (netting is not required), and

    - If the investor has both 1231 gains and 1231 losses, the investor can invest all the gains (not just the net 1231 gain).

- **<u>Leased property</u>**. The final regulations should clarify that leased property is classified as an intangible asset for purposes of the qualified opportunity zone business tests. As intangible property, the leased property is subject to the tangible asset rules. Thus, an opportunity zone business could acquire property by lease before or after 2018, and from an unrelated or related person, without disqualifying the leased property. The leased property would be subject to the rule that a substantial portion of intangible property must be used in the active conduct of the trade or business in the opportunity zone. In addition, as discussed above, construction of a building on leased land should be permitted (that is, the building should be treated as qualified if it meets the tangible asset requirements, notwithstanding that it is constructed on leased land).

- **Replacing non-deferred gain amounts** – The final regulations should provide that an investor may contribute non-rollover amounts and later replace them with deferred gain contributions. The holding period for the qualified interest would begin on the date that the non-rollover amount is replaced with the deferred gain contribution.

- **Non-US Investors** – The final regulations should clarify that if an investor is a non-US person, the deferred gain is subject to withholding under sections 1441, 1445, or 1446 when included in income on December 31, 2026 and not at the time the sale took place.

- **Installment sales** – The final regulations should clarify that:

  - In an installment sale transaction, the taxpayer may elect to reinvest gain each year in which gain is recognized, and

  - If the installment sale is made by a partnership, the election may be made within 180 days after the end of the partnership's tax year in which the gain would otherwise be recognized by the partnership.

- **Spa facilities in hotels and rental properties** – The final regulations should clarify that full-service spa facilities should not be a "sin business" described in Section 144(c)(6) so as to disqualify a QOZ property by reason of the massage parlor and hot tub restrictions.

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The Opportunity Zone legislation has the potential to be a powerful catalyst for transformational real estate investment in parts of the country that need capital and well-paying jobs. With the regulatory regime now coming into focus, The Roundtable foresees opportunity fund investors and fund managers actively partnering with local leaders and entrepreneurs on projects that both drive economic activity and respond to the needs of communities. Additional guidance along the lines described above will help ensure that the opportunity zone incentives fulfill their ambitious objectives.

The Real Estate Roundtable looks forward to working with you as you consider the many issues arising in the implementation of the program. Please do not hesitate to contact me or Ryan McCormick, Real Estate Roundtable Senior Vice President and Counsel, at (202) 639-8400 with any questions or requests for additional information.

Sincerely,

Jeffrey D. DeBoer
President and Chief Executive Officer