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July 1, 2019

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

The Honorable Michael J. Desmond
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Guidance Regarding Opportunity Zones [REG-120186-18]

Dear Assistant Secretary Kautter and Chief Counsel Desmond:

Proposed regulations released in April thoughtfully address critical issues regarding the Opportunity Zone tax incentives and bring us closer to full implementation of the new law. The Real Estate Roundtable believes the most recent guidance is accelerating capital formation, job creation, and productive real estate investment in struggling, low-income communities. Nonetheless, certain questions remain that warrant additional, clarifying guidance.

Following up on our prior comment letters, recommended clarifications for the final regulations are discussed below. The recommendations were developed by The Roundtable's Opportunity Zone Working Group, which includes leaders of the nation's top real ownership, development, lending, and management firms, representatives of the major national real estate industry associations, and outside advisors.

Executive Summary of Real Estate Roundtable Recommendations

- Section 1231 gain.** To maximize the redeployment of capital for Opportunity Zone purposes, the final rules should allow taxpayers to invest section 1231 gain in a qualified opportunity fund (QOF) without a netting requirement. In addition, the rules should allow taxpayers to elect to invest section 1231 gain at the time of the sale/exchange, rather than waiting until the end of the year. Lastly, the rules should provide flexibility with respect to the investment period when the seller of the property is a partnership, similar to the rules for capital assets.
- Aggregator funds.** The proposed regulations create favorable rules that should facilitate the formation and administrative operation of multi-asset opportunity funds by allowing investors to contribute their QOF interests to an upper-tier partnership (Aggregator fund). The final rules should clarify that these "roll up" rules will be respected for tax purposes when the aggregation is part of the fund formation process. The rules should also clarify that a merger of QOFs is not an inclusion event.

3. **Related party rules.** If an existing owner/developer is willing and able to facilitate a substantial new investment in an Opportunity Zone asset and subordinate his or her right to share in the profits, the Opportunity Zone rules should not unnecessarily discourage the owner from doing so by precluding him or her from retaining a capital and/or profits interest, particularly when there are no Opportunity Zone tax benefits associated with the profits interest. The final rules should clarify that a profits interest is excluded from consideration for purposes of measuring compliance with the Opportunity Zone related party rules.
4. **Working capital safe harbor and the 70/30 test.** Some question whether a qualified opportunity zone business (QOZB) that otherwise satisfies the working capital safe harbor could still fail the 70% QOZBP tangible property threshold during the period working capital is being expended. The final rules should clarify the application of the 70/30 test when capital is being expended during the working capital safe harbor period. Options: treat any tangible property that is intended to be used in the zone when placed in service as qualifying property; assume that all working capital that will be expended has been expended before each testing period; or do not apply the 70/30 test until all working capital has been expended and the substantially improved or new building is placed in service.
5. **Vacant buildings and original use.** The final regulations should encourage new investment in Opportunity Zones, while also avoiding any incentive for existing owners to vacate a building to improve its marketability, by adopting the vacancy test set forth in existing Treasury regulations for empowerment zones. Specifically, the final rules should replace the 5-year rule in the proposed regulations with the one-year vacancy test in the Empowerment Zone regulations, which also requires that the building was vacant on the date of the zone's designation.
6. **Aggregation of assets.** Allowing the aggregation of assets for purposes of the substantial improvement test will encourage funds to take on more ambitious and transformative projects. The final rules should allow a QOF or QOZB to aggregate assets on the same tract or contiguous tracts under a test similar to the section 1250 regulations, which allows for aggregation of structures that are operated as an integrated unit (as evidenced by their actual operation, management, financing, and accounting).
7. **Real estate straddle rule.** Additional clarifications are needed to ensure the real estate straddle rule operates as intended. The final rule should apply for all Opportunity Zone purposes, not just the 50% gross income test. It should apply to both leased and owned parcels. The rule should clarify the ways in which an Opportunity Zone property can be "substantial" relative to the non-zone property. Contiguous property should include properties separated by roads and other public property.
8. **Replacing old buildings.** In many cases, an opportunity fund may acquire a dilapidated building that it intends to demolish—constructing a new building in its place—but cannot do so immediately. The final rules should provide that improved land with buildings that will be demolished within 30 months will be treated as unimproved land for Opportunity Zone purposes.
9. **Exclusion of gain after 10 years.** Treasury should issue guidance as soon as possible confirming that investors can rely on the proposed rule that allows taxpayers to exclude gain when an opportunity fund sells an asset after 10 years. This guidance is needed to provide investors in professional, multi-asset opportunity funds with important tax assurances and accelerate the flow of investment into the designed, low-income communities. The final rules should also clarify that the exclusion applies to the sale of assets by a QOZB, not just a QOF.

10. **REIT-specific issues.** The final rules should include a number of clarifications important to the operation and management of real estate investment trusts (REITs) and endorsed by Nareit. These relate to: (a) when REIT capital gain dividends can be invested in a QOF; (b) the application of section 291 recapture rules; (c) how the Opportunity Zone rules apply to REIT earnings and profits, and (d) the extension of the Opportunity Zone tax benefits to REIT shareholders who invest in a QOF through upper-tier REITs.

Detailed Analysis

Section 1231 gain

In order to achieve the legislative objective of boosting economic growth by stimulating the redeployment of capital to low-income communities, the final Opportunity Zone regulations should allow the deferral of section 1231 gain into a qualified opportunity fund (QOF) without unnecessary restrictions on the timing of the deferral or a requirement for netting with section 1231 losses.

More specifically, rather than imposing a netting requirement, we recommend that section 1231 gain be treated as recognized for Opportunity Zone purposes as a discrete tax item at the time the applicable section 1231 property is sold or exchanged. We further recommend that the amount of gain recognized on a sale of section 1231 property be eligible for investment as a separate and discrete amount for a 180-day investment period commencing on the date the 1231 property is sold or exchanged.

The section 1231 gain rules should then track all the rules applicable to capital gain, including the choice, in cases where the seller is a partnership, of allowing the 180-day investment period to run at both the partnership and the partner level, and having the 180-day period commence either on the date the property is sold or on the last day of the partnership tax year (generally December 31 for a partnership with individual partners).

There is no statutory requirement, or clear policy rationale, that suggests the regulations must limit eligible gain to netted section 1231 gain. The preamble to the October proposed regulations indicated that Treasury and the IRS believe that the legislative history, as well as the text and structure of the statute, support an interpretation that limits eligible gain to capital gains. However, the same preamble noted that the “statutory text is silent as to whether Congress intended both ordinary and capital gains to be eligible for deferral.” Although the conference report states that the provision “provides for the temporary deferral of inclusion in gross income for capital gains reinvested in a [QOF],” this statement on its own is not self-limiting or necessarily exclusive.

Perhaps most importantly, as described in greater detail in attachment 1, the actual structure of the statute supports an interpretation that section 1231 gain should qualify. For example, these structural elements of the statute include the 180-day reinvestment period. By providing a 180-day investment period “beginning on the date of such sale or exchange,” we believe that Congress intended for gain to be measured on an asset-by-asset basis without regard to the otherwise applicable tax rules that require the “netting” of gains and losses. In fact, the “netting” rules for capital gains (set forth in section 1222) and for section 1231 property (set forth in section 1231(a)) are for all intents and purposes substantively and procedurally the same. The proposed regulations have already recognized that a taxpayer with capital gain from a single transaction can invest such gain as a separate tax item even though the taxpayer may have other capital losses in the same

tax year that would otherwise offset and reduce (or even entirely eliminate) the single discrete item of capital gain being reinvested by the taxpayer under section 1400Z-2(a). Congress clearly intended for eligible gain from a sale or exchange to be redeployed into eligible investments in QOFs within a relatively short time period, 180 days, after “the date of such sale or exchange.”

Section 1231 has long-standing anti-abuse provisions contained in section 1231(c) that deal with the obvious opportunities for manipulation of capital gain and ordinary loss under section 1231, and these anti-abuse rules have existed for many years wholly independent of the Opportunity Zone tax incentives. These existing protections against abuse are also discussed in attachment 1.

The ability to defer fully section 1231 gain would provide a critical source of additional capital for Opportunity Zone investment. According to IRS line item estimates from Form 4797, net section 1231 gain was more than \$160 billion in 2016 alone.¹ Section 1231 gain generally refers to property, held for more than one year and used in a trade or business, which is either real property or property of a character subject to the allowance for depreciation. I.R.C. § 1231(b)(1). In practice, section 1231 gain can arise from the sale of a wide variety of assets, including land, buildings, and machinery. Because section 1231 assets are used in a trade or business, the owners of section 1231 assets are often active and directly involved in the business. Facilitating the redeployment of section 1231 gain in Opportunity Zones will encourage existing business owners and entrepreneurs to create jobs and expand their investment in the designated communities.

Alternatively, if the Treasury does not adopt the foregoing recommendations, we request that a “grandfathering” provision be adopted whereby a taxpayer that has invested section 1231 gain in a QOF in a taxable year ending on or before December 31, 2019, in a manner that would qualify if such gain were capital gain, be treated as making an eligible investment (*i.e.*, adopt our recommendations above for a transaction period for tax years ending on or before December 31, 2019). This potentially could be accomplished with an update to the final question on the Opportunity Zones Frequently Asked Questions² to make it clear that any section 1231 gain generated prior to May 1, 2019 can be validly deferred.

Lastly, we request that the final regulations or related guidance (or forms) confirm that partnerships may defer gain from section 1231 property. Although several government representatives have made unofficial statements at various public speaking engagements which confirm their view that partnerships can defer such gains, it would provide greater certainty to the investing community and assist in spurring investment in Opportunity Zones if the IRS and Treasury Department could provide greater clarity with respect to partnership deferral of gain from section 1231 property.

Aggregator funds

The proposed rule allowing investors to contribute their opportunity fund interests to an upper-tier partnership (“Aggregator”) that acts as an aggregator of fund interests is a well-intended simplification that should make it easier to structure professional, diversified, multi-asset opportunity funds. However, we

¹ IRS Pub. #4801, Individual Income Tax Returns: Line Item Estimates 2016, p. 129-131 (Sept. 2018), available at: <https://www.irs.gov/pub/irs-soi/16inlinecount.pdf>.

² IRS, Opportunity Zones Frequently Asked Questions (last updated June 26, 2019), available at: <https://www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions>.

remain concerned that if an opportunity fund agreement directs investors to contribute their interests to an Aggregator fund after investors initially invest into one or more QOFs, the transactions could be disregarded under a step transaction analysis. The final regulations should clarify:

- a. that such “roll up” transactions will be respected for tax purposes, even when they are part of the fund formation process;
- b. one or more new QOFs also may be formed by an Aggregator after the roll-up to acquire additional properties; and
- c. although the Aggregator is not a QOF itself, the sale of the ownership interests in the Aggregator will be treated as the sale of the interests in the underlying QOFs owned by the Aggregator for purposes of excluding the gain on the sale of an interest in the Aggregator by an owner whose aggregate hold period for the contributed QOFs and the Aggregator interest is at least 10 years.

Additionally, the proposed regulations specify that a merger or consolidation of upper-tier partnerships holding a qualifying investment is not an inclusion event. It would be helpful to add mergers of QOFs to this section, thereby making it clear that a merger of two or more QOFs is not an inclusion event. Similar to above, this would allow funds to issue one K-1 to investors from the merged QOF in place of a K-1 from each separate original QOF, greatly reducing the compliance burden for managers.

Related party rules—measuring a related interest

The proposed rules do not address when and how certain interests in a QOF, such as a carried interest, should be measured for purposes of determining whether the QOF has acquired property from a related party.³

This uncertainty is having a negative impact on the ability of existing owners/developers to participate in projects on terms that appropriately reflect the risks taken by the developer when the project is in the planning stages and capital from an opportunity fund is necessary to get the project off the ground. If an existing owner is willing and able to facilitate a substantial new investment in an Opportunity Zone asset and subordinate his or her right to share in profits, the Opportunity Zone rules should not unnecessarily discourage the owner from doing so by precluding him or her from retaining a capital and/or profits interest, particularly when there are no tax benefits associated with the profits interest.

The returns to a developer in a real estate project are often a subordinated right to a carried interest of 20% or more, after certain return thresholds are achieved by the capital partner. For many decades, this model has provided an efficient allocation of risks to enable capital formation, entrepreneurial activity, and productive investment. Unfortunately, in situations where the developer owns land in an Opportunity Zone and desires to participate in the venture primarily through a carried interest payable only if the project is successful, the uncertainty of the Opportunity Zone related party rules prevent a carried interest under market terms.

³ See I.R.C. §1400Z-2(e)(2) and Prop. Reg. §1.1400Z-2(d)-1(c)(4)(i)(A). The proposed regulations do clarify that a partnership interest received in exchange for services is a nonqualifying investment for purposes of the Opportunity Zone tax benefits. The proposed regulations further provide specific rules for how a mixed-fund investment is allocated between qualifying and nonqualifying investments to determine the amount eligible for tax benefits. Prop. Reg. §1.1400Z-2(b)-1(c)(6)(iv)(D). However, these rules do not address the separate question of when and how to account for a profits interest under the related party rules.

Qualified opportunity zone business property (QOZBP) must be acquired by purchase (as defined in section 179(d)(2)) after December 31, 2017. IRC §1400Z-2(D)(i)(I). Section 179(d)(2) provides that the term “purchase” includes any acquisition, but only if the property is not acquired from a person whose relationship to the person acquiring it would result in the disallowance of losses under section 267 or 707(b), with certain modifications. As applied to partnerships, section 707(b) provides that losses are disallowed between a partnership and a person owning more than 50% of the capital interest or the profits interest in such partnership. For purposes of determining if persons are related under section 1400Z-2, the 50% test of section 707(b) and 267 is replaced with a 20% test.

While the acquisition of QOZBP must be by purchase from an unrelated person, we recommend that the final regulations recognize that a carried interest is not the equivalent interest in profits of a partnership as would be a pro rata share in all profits. More specifically, the regulations should clarify that the determination of the interest in profits for purpose of applying the related persons tests under section 1400Z-2(D)(i)(I) is determined at the time of the purchase of property by the QOF or QOZB. Additionally, regulations should establish a safe harbor to provide that a person’s interest in profits with respect to a carried interest is zero on the date of grant of the carried interest if the carried interest complies with the requirements of Rev. Proc. 93-27.⁴ While Rev. Proc. 93-27 establishes that the value of a profits interest is deemed to be zero and does not quantify the percentage interest in profits with respect to the interest, a determination that such interest also is deemed to constitute an 0% interest in profits for purposes of section 1400Z-2 is consistent with a zero value. Alternatively, the test could provide that the interest in profits is determined by the percentage of profits that would be allocated to such interest upon a hypothetical liquidation immediately after the grant of the profits interest as provided under Rev. Proc. 93-27.

A final rule along these lines is consistent with both the purposes of the Opportunity Zone law and general tax principles related to the grant of a profits interest. It will allow for traditional developer incentives to timely develop projects and attract capital by allowing for a larger share of potential residual profits to the developer, but only after the capital partner receives a threshold return. It will discourage the unnecessary and uneconomic sale of properties when a better result could be achieved by encouraging capital providers to partner with existing owners who have knowledge and understanding of the local community and its needs.

Working capital safe harbor and the 70/30 test

The proposed regulations leave some questions outstanding regarding the interplay of the working capital safe harbor and the 70% QOZBP tangible property threshold requirement during the development phase of a real estate project. Specifically, there are concerns that a QOZB that otherwise satisfies the working capital safe harbor may still not meet the 70% QOZBP tangible property threshold requirement during the period working capital is being expended.

The example in Prop. Reg. §1.1400Z-2(d)-1(d)(5)(viii) illustrates the application of the working capital safe harbor where the taxpayer as a result of the planned expenditures of its working capital assets is expected to acquire land and construct a commercial building. However, the example fails to explicitly address the application of the 70% QOZBP tangible property threshold during the period that working capital is being expended on the construction of the commercial building. As a result, some question whether a QOZB that otherwise satisfies the working capital safe harbor could still fail the 70% QOZBP tangible property

⁴ Rev. Proc. 93-27, 1993-2 C.B. 343.

threshold during the period working capital is being expended. In contrast, the example makes clear that if the taxpayer had instead had a working capital plan to substantially improve the acquired building (rather than construct it new), and had not yet doubled the basis, the building would not be treated as failing to satisfy the requirements necessary to be treated as QOZBP.

There are a few options to address this discrepancy. The final regulations could treat any tangible property that is intended to be used in the zone when placed in service as qualifying property for purposes of the 70% QOZBP tangible property threshold requirement. Alternatively, the regulations could assume that all working capital that will be expended has been expended before each testing date, including future tranches of working capital that as part of the working capital plan will be used to substantially improve or construct new property. Lastly, the final rules could provide that the 70% QOZBP tangible property threshold requirement is not applied at the QOZB level until all working capital has been expended and the substantially improved (or new) building is placed in service in the QOZB.

Vacant buildings and the original use requirement

The preamble to the proposed regulations indicates that Treasury and the IRS considered multiple comments on the issue of original use and vacant buildings. Several commenters suggested establishing an “at least one year” vacancy period, similar to that employed in other Treasury regulations, to determine whether property meets the original use requirement. Others proposed longer vacancy requirements ranging up to five years. Citing a concern that a period of 12 months might incentivize existing owners to intentionally vacate assets in order to increase marketability, Treasury proposed a period of vacancy of at least five years.

The final regulations could encourage new investment in Opportunity Zones while also avoiding any incentive for existing owners to vacate a building to improve its marketability by adopting the vacancy test set forth in existing Treasury regulations for empowerment zones. Treas. Reg. §1.1394-1(h) states, in relevant part, that “if property is vacant for at least a one-year period *including the date of zone designation*, use prior to that period is disregarded for purposes of determining original use” (emphasis added). The regulation makes it clear that the property had to be vacant on the date that the zone was designated. Vacating the asset after the date it was designated, be it for a one-year period or a five-year period, would not qualify for zone benefits under Treas. Reg. §1.1394-1(h). This language makes it impossible for an owner to take advantage of the legislation or otherwise game the system by vacating an asset after its census tract was designated as an Opportunity Zone.

In contrast, the five-year vacancy rule in the proposed regulations will have the unintended effect of discouraging the redevelopment of existing, vacant buildings that were not being put to productive, economic use when Opportunity Zones were designated in April 2018. The proposed rule would result in many properties, including properties that were vacant when Opportunity Zone designations were made, remaining vacant in order to qualify under the original use test, thereby delaying investment. Yet these languishing properties are the exact types of assets most in need of rehabilitation to help revitalize low-income communities, create jobs, and generate new tax revenue for schools, roads, and law enforcement. The one-year rule in Treas. Reg. §1.1394-1(h) would help put these vacant buildings into service sooner, increasing the likelihood of success for the impacted community.

Additionally, in order to allow buildings vacated after the date of zone designation to qualify under the original use provision, the final regulations could include both the provision under §1.1394-1(h) and a vacancy rule similar to the one in the proposed regulations. However, we believe requiring a building to be

vacant for a 5-year period before qualifying under the original use test is inconsistent with the intent of the Opportunity Zone legislation and will discourage much-needed rehabilitation of real estate located in low-income communities. Therefore, in the case of buildings vacated after a zone designation is made, we recommend that the final regulations shorten the required period of vacancy from 5 years to 2 years.

Aggregation of assets

Allowing the aggregation of assets for purposes of the substantial improvement test would encourage opportunity funds to take on more ambitious, transformative projects. The excess capital expenditures from one project could offset other projects that are not as capital intensive.

The final regulations should permit a QOF or QOZB to aggregate assets on the same tract or contiguous tracts of an Opportunity Zone under a test similar to the section 1250 regulations, which sets forth a test under which buildings may be aggregated and treated as a single item of section 1250 property.⁵ Under this test, structures may be aggregated if they are “operated as an integrated unit (as evidenced by their actual operation, management, financing, and accounting).”⁶ Permitting buildings to be aggregated under this standard would serve the purpose of consistency in the tax code in general, as well as the legislative purposes of the Opportunity Zone rules.

Real estate straddle rule

The proposed regulations seek to clarify that real estate that straddles an Opportunity Zone border can qualify as QOZBP as long as the portion of the property that is inside the zone is substantial relative to the total property. Unfortunately, as currently drafted, the proposed straddle rule does not achieve its objective. We believe the final regulations should modify the proposed rule along the following lines (see attachment 2 for draft regulatory language):

1. The final regulations should clarify that properties do not cease to be contiguous because they are separated by public property (*e.g.*, a road or sidewalk). Census lines generally are drawn along roads, so the straddle rule would be largely meaningless if a road broke continuity.
2. The final regulations should confirm that the rule applies for all Opportunity Zone purposes, including the 70% QOZBP tangible property threshold requirement. The proposed straddle rule applies “for purposes of satisfying the requirements of paragraph (d)(5) [of Prop. Reg. §1.1400Z2(d)-1].” That paragraph deals only with the incorporation of certain requirements of section 1397C (*i.e.*, the 50% income test, the “substantial portion” requirement for intangibles, and the limitation on nonqualified financial property). The preamble, by referencing section 1400Z-2(d)(3)(A)(ii), suggests the same result. Importantly, neither of these cross-references include the requirement in the definition of QOZBP that “substantially all of the use of the property” be in an Opportunity Zone (the “QOZBP use requirement”). Accordingly, the straddle rule, if read literally, may provide relief

⁵ Treas. Reg. §1.1250-1(a)(2)(ii).

⁶ ABA Section of Taxation, Comments on Proposed Regulations Regarding Investment in Qualified Opportunity Funds Under Section 1400Z-2, at 39-42 (Jan. 10, 2019).

on the income test and intangible requirements but might cause the contiguous non-zone property to not be treated as a good asset for the 70% QOZBP tangible property threshold requirement.

The straddle rule would be largely meaningless if it only fixed the issue for some but not all of the relevant Opportunity Zone requirements. For example, assume a QOZB purchases, as its only assets, a 6000 sq. ft. zone property for \$60x, and a contiguous 4000 sq. ft. non-zone property for \$40x. In this case, the straddle rule would apply to treat the non-zone property as a zone property for purposes of the section 1397C requirements. However, without a modification, the non-zone property would not satisfy the 70% QOZBP tangible property threshold requirement and would thus fail to be QOZBP, and because the non-zone property represents more than 30% of the business's tangible assets, the business would fail to be a QOZB, which would disqualify the QOF that owns it. Similarly, if the property were acquired directly at the QOF level, it would likewise fail to be QOZBP and similarly disqualify the QOF. In addition, the structure of section 1397C itself, which Treasury was clearly trying to conform to, indicates that the straddle rule should apply more broadly. In particular, section 1397C(b)(3) has a use requirement that is analogous to the QOZBP use requirement, and on which the QOZBP use requirement was based, and the section 1397C(f) straddle rule applies for purposes of that use requirement. To achieve the intended parity, the straddle rule should apply to the QOZBP use requirement.

3. The final regulations should clarify that the straddle rule applies flexibly to both leased and owned parcels. It is unclear, especially in light of the preamble's reference to unadjusted cost basis, how the straddle rule is supposed to apply when the QOF or QOZB leases the contiguous parcels, or owns one parcel and leases the other. The final regulations should confirm that the rule applies as long as the QOF or QOZB has either a leasehold or an ownership interest in each of the parcels, and that in testing the substantiality of the zone parcel, the taxpayer may measure either by square footage or value of the leased property (as determined under the general opportunity fund valuation rules). The regulations clearly reflect an intent to allow QOZBs to lease property, and to ensure that QOZBs are not disadvantaged based on their decision to own or lease property, and accordingly businesses that lease their property should get the benefit of the straddle rule in order to be on parity with businesses that own their property. Moreover, there is no policy reason the straddle rule should differ for owned vs. leased property.
4. The final regulations should clarify the ways in which zone property can meet the "substantial" requirement for purposes of the straddle rule. We recommend that Treasury provide specific safe harbors that treat a property as "substantial" relative to contiguous non-zone property. A zone property should be treated as substantial if: (a) the square footage, unadjusted basis, or FMV of the land footprint of the zone property is greater than that of the non-zone property, or (b) the property meets other qualitative measures, *e.g.*, the zone property is an integral and important part of the business operated on the non-zone property. Treasury should also clarify that square footage for purposes of the foregoing is determined only by reference to land footprint, and not by reference to air rights or cumulative square footage in a multi-floor building. Quantitative safe harbors are needed to provide certainty. However, such quantitative safe harbors may not be flexible enough to capture all instances in which the straddle rule is appropriately applied, and thus a qualitative test is also appropriate. With respect to the square footage calculation, using land footprint would provide for a clear and easily administrable rule that cannot be manipulated by the types of buildings that are built on the property. With respect to the unadjusted basis or FMV calculations for testing substantiality

for the straddle rule, these should be measured only once at the time of lease or acquisition to also provide for a clear and easily administrable rule.

Replacing old buildings

In many cases, an opportunity fund may acquire a dilapidated building that it intends to demolish—constructing a new building in its place—but cannot do so immediately. For example, the building may be subject to a current lease. Presumably, the existing building is not going to be substantially improved, nor will it be put to its original use, but this is the type of significant, ground-up development that will spur jobs, growth, and revenue for public needs. The final regulations should provide that improved land with buildings that will be demolished within 30 months will be treated as unimproved land for Opportunity Zone purposes.

Exclusion of gain after 10 years

By allowing an opportunity fund investor to exclude gain when an opportunity fund sells an asset after 10 years, the most recent proposed regulations should help facilitate the structuring of professionally managed, multi-asset opportunity funds and the pooling of capital from diverse sources.

However, because taxpayers may not rely on this provision unless and until it is finalized, sponsors cannot yet raise capital for qualifying Opportunity Zone investments in a typical structure familiar to investors where a single QOF may own multiple subsidiary QOZBs and dispose of them separately while obtaining the 10-year gain exclusion intended by Congress. In order to maximize the effectiveness of this new rule, we request expedited Treasury guidance as soon as possible allowing taxpayers to rely on this provision while Treasury is finalizing the regulation.

Second, the proposed rules state that when a QOF partnership interest is sold after 10 years, the basis of the QOF partnership's assets is also stepped up immediately prior to the sale of the partnership interest (likening the calculation to a transfer with a section 754 election in effect). Although this new rule would permit the basis of the assets of a QOF to be increased, the final regulations should clarify that the basis of assets owned in a subsidiary QOZB will also be stepped up (the basis of the underlying property is not increased under the current language). We recommend that the final regulations clarify that gain arising from a sale of property owned by the QOZB itself would also be permitted to be excluded under the election.

Finally, to make the provisions workable in a practical context, the disposition rules should:

- a. Permit the basis step-up to occur both (a) upon the post-10 year disposition of an interest by the QOF of its interest in a QOZB or (b) upon the post-10 year disposition by a QOZB of its underlying property, and
- b. Provide flexibility by allowing a tax-free division of a QOF owning multiple properties into separate QOFs having carryover attributes without requiring an inclusion event (as would be permitted to occur tax free with a standard partnership division transaction).

REIT-specific issues

For REIT capital gain dividends, the 180-day deferral period should begin 30 days after the close of the REIT's taxable year

As we requested in our December 19, 2018 letter and Nareit recommended in its [Dec. 26, 2018 letter](#) regarding the 2018 proposed regulations, the 180-deferral period for REIT capital gain dividends should begin 30 days after the close of the REIT's taxable year, rather than on the date of the distribution. A REIT can only designate a capital gain dividend as such with certainty after the close of its taxable year; as a result, neither a REIT nor a shareholder will know on the date of a particular distribution whether that distribution is a capital gain dividend. The current proposed rule is unworkable for REITs.

Confirm that section 291's recapture rule does not apply to unrecaptured section 1250 gain in the year of the sale or exchange to the extent that gain is deferred with a QOF investment

Section 291 raises a potential concern in the context of a REIT's deferral of gain through a qualifying Opportunity Zone investment. Specifically, section 291(a) generally provides that, if a corporation recognizes unrecaptured section 1250 gain, 20% of that gain is treated as ordinary income. Section 291(d) generally provides that the amount of a REIT's unrecaptured section 1250 gain that is treated as ordinary income is reduced to the extent the gain is distributed as a capital gain dividend to the REIT's shareholders. Section 291 was enacted when there was a preferential corporate tax rate for capital gains, which is no longer the case. Instead, section 291 may now be a trap for a REIT that is seeking to invest unrecaptured section 1250 gain into a QOF. As recommended by Nareit, the final regulations should confirm that section 291 does not apply to unrecaptured section 1250 gain in the year of the sale or exchange to the extent that gain is deferred with a QOF investment. Instead, the recapture rule in section 291 should apply when the gain is included in gross income in 2026 (or earlier if there is an inclusion event).

Clarify REIT earnings and profits rules so that a REIT and its shareholders are treated consistently under the Opportunity Zone rules

The Opportunity Zone rules provide for a step up in basis of the QOF interest after 5 years, after 7 years, and after 10 years. The intent of those step ups is to allow taxpayers to permanently defer recognition of certain income. However, when a REIT holds a QOF interest, because a REIT shareholder is taxed on a REIT distribution to the extent of a REIT's current and accumulated earnings and profits (E&P), the rules do not achieve that objective if the basis step ups do not also apply for purposes of computing a REIT's E&P. If the basis step-up rule does not also apply for E&P purposes, then a REIT's distribution of gain from the disposition of a QOF interest may actually result in ordinary income to its shareholders from the REIT's distribution of such QOF gain, rather than even capital gain. Consistent with Nareit's recommendations, the final regulations should confirm that the basis step-up also applies for REIT E&P purposes and that the REIT will not have E&P as a result of gain from a QOF that is not recognized for taxable income purposes due to the basis step up rules. Alternatively, similar to the capital gain dividends distributed by a QOF REIT, a REIT that makes a qualifying QOF investment should be able to make tax-exempt capital gain dividends to its shareholders, to the extent attributable to the REIT's tax-exempt gain with respect to such QOF investments.

Confirm that the Opportunity Zone tax benefits apply to shareholders who invest in QOF REITs through upper-tier REITs

Prop. Reg. § 1.1400Z2(c) 1(e) allows capital gain dividends paid by a QOF REIT (a REIT that is itself a QOF) to be received by shareholders in a tax-free manner if, on the date the QOF REIT identifies the dividend as a capital gain dividend, the shareholder has held the qualifying investment for at least ten years. Specifically, when a QOF REIT shareholder holds shares representing a qualifying investment and receives

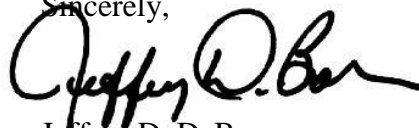
a capital gain dividend, it may treat that dividend as a qualifying gain subject to a 0% federal tax rate. A REIT that is an equity holder in a QOF that is *not* a REIT may realize tax-exempt gain under section 1400Z-2(c) when it disposes of the qualifying investment after a ten-year holding period. Consistent with Nareit's comments, we recommend that the section 1400Z-2(c) basis step-up be applied for E&P purposes and that the REIT not have an increase to E&P as a result of the qualifying disposition. In addition, a REIT that makes a qualifying QOF investment should be able to make tax-exempt capital gain dividends to its shareholders, to the extent attributable to the REIT's tax-exempt gain with respect to the disposition of such qualifying investments after a 10-year holding period.

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Opportunity Zones can be a powerful catalyst for transformational real estate investment in economically struggling parts of the country. Partnering with local leaders and entrepreneurs, real estate-focused opportunity funds will spur long-term, patient investment that drives productive economic activity. Real estate projects financed through opportunity funds will generate well-paying jobs, improved infrastructure, and a built environment that helps attract and retain new businesses and employers. Regulatory clarifications along the lines described above will help ensure that the Opportunity Zone incentives fulfill their ambitious objectives.

The Real Estate Roundtable appreciates the opportunity to share our comments as you finalize the Opportunity Zone implementing regulations. 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,

A handwritten signature in black ink, appearing to read "Jeffrey D. DeBoer". The signature is fluid and cursive, with a large initial "J" and "D".

Jeffrey D. DeBoer
President and Chief Executive Officer