Internal Revenue Service

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PLR-105848-22

Date:
October 17, 2022

TY:

Legend

Taxpayer	=
Date 1	=
Project	=
City	=
Initial QOZB A	=
Initial QOZB B	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Date 6	=
Date 7	=
Date 8	=
Date 9	=
$y	=
Date 10	=
Date 11	=
Participating QOFs	=

Dear :

This letter supersedes our letter, dated September 12, 2022, for correction of obvious error.

This ruling responds to Taxpayer's request for a letter ruling, dated Date 1, on the application of the 50% gross income requirement under § 1400Z-2(d)(3)(A)(ii) of the Internal Revenue Code (Code). Specifically, Taxpayer is requesting a ruling that the gross income derived by Taxpayer from the sale of land may be treated as gross income derived from the active conduct of a trade or business in a qualified opportunity zone (QOZ) for purposes of satisfying § 1400Z-2(d)(3)(A)(ii) of the Internal Revenue Code (Code), provided that Taxpayer adopts a new or revised working capital plan within 120 days of the end of the qualified disaster incident period satisfying the requirements of § 1.1400Z2(d)-1(d)(3)(v)(A) through (E) of the Income Tax Regulations (Regulations) and that plan utilizes the proceeds of such sale (net of any tax distributions) in a manner such that the completion of spending takes into account the originally allowed up-to-31 month period and up-to-24 additional months where applicable provided by § 1.1400Z2(d)-1(d)(3)(v)(B) of the Regulations and § 1.1400Z2(d)-1(d)(3)(v)(D) of the Proposed Income Tax Regulations (Proposed Regulations).

FACTS

Taxpayer represents the facts are as follows:

The Project is a real estate project being developed in a QOZ located in City. The Project consists of the development and construction of new retail and multifamily housing. As part of the financing of the Project, multiple separate qualified opportunity funds (QOF) were created and formed for the sole purpose of investing in the Project (together, "Participating QOFs"). Taxpayer represents that each Participating QOF has timely self-certified and continues to satisfy the requirements under §§ 1400Z-2(d) of the Code and the regulations thereunder.

Two separate qualified opportunity zone businesses (QOZB), Initial QOZB A and Initial QOZB B (together, "Initial QOZBs"), were also created for the sole purpose of developing, constructing and operating the Project and were treated as partnerships for Federal tax purposes. Initial QOZB A and Initial QOZB B created and formed wholly owned, disregarded subsidiaries for the sole purpose of acquiring certain parcels of land for the development and construction of buildings.

On Date 2, Date 3, and Date 4, the Participating QOFs funded both Initial QOZB A and Initial QOZB B. Initial QOZB A used the funds plus a promissory note to purchase Parcel B. Initial QOZB B used the funds plus a promissory note to purchase Parcel C. Both purchases were from an unrelated third party. On Date 3, upon receipt of the first tranche of capital, each QOZB adopted an initial working capital plan and written schedule.

On Date 5, the QOFs funded both Initial QOZBs. Expenditures by Initial QOZBs were expended in a manner substantially consistent with the working capital plan and the

written schedules originally adopted by the QOZBs upon receipt of the first and second tranches of funding. On Date 5, upon the receipt of the second tranche of capital, the working capital plan and written schedule were supplemented by additional written plans reflecting the additional capital.

Throughout this period beginning with Date 2 and through the merger transaction on Date 6, Initial QOZBs continued to maintain working capital plans and updated written schedules intended to satisfy § 1.1400Z2(d)-1(d)(3)(v) of the Regulations, including on each date of the QOZB testing dates determined to apply between the initial funding date through the merger transaction. In addition, each QOZB properly designated the cash amounts as working capital assets pursuant to its written schedules such that the unexpended balances held on each of the applicable QOZB testing dates as reasonable in amount for purposes of applying the nonqualified financial property limitation.

On Date 6, Initial QOZB A merged into Initial QOZB B under state law and formed Taxpayer. Taxpayer is organized as a partnership and uses the accrual method. Between Date 6 and Date 7, Taxpayer incurred additional predevelopment costs. The amount was expended in a manner substantially consistent with the working capital plan and the written schedules originally adopted and subsequently supplemented.

On Date 8, an unrelated third party, unsolicited, approached Taxpayer to purchase Parcel B. On Date 8, Taxpayer entered into a purchase and sale agreement to sell Parcel B to the unrelated third party for $y. Taxpayer represents that because of the sale of Parcel B, Taxpayer will need to revise the scope of the Project to fit entirely within Parcel C. Taxpayer also represents that any gain on the sale of Parcel B is expected to be allocated to its partners and subject to income tax. Additionally, Taxpayer represents that Taxpayer will reinvest the additional proceeds received from the sale of Parcel B (net of tax distributions) in the Project and the project scope reduced. Further, Taxpayer also represents that the Covid-19 pandemic has significantly impacted and delayed the Project.

Taxpayer also intends to adopt a new or revised working capital safe harbor plan to reflect the revised scope. The revised plan will decrease the number of residential units and retail square footage and extend the completion date by a few years.

Taxpayer further represents that throughout the post-merger period beginning Date 6 through the date of filing this ruling request, Taxpayer has continued to maintain working capital plans and written schedules intended to satisfy the requirements of § 1.1400Z2(d)-1(d)(3)(v) of the regulations including on each of the QOZB testing dates determined to apply between the merger date and the filing of this ruling request.

RULING REQUESTED

Taxpayer requests a ruling that the gross income derived by Taxpayer from its sale of Parcel B, which occurs during Taxpayer’s start-up period, may be treated as gross

income derived from the active conduct of a trade or business in a QOZ for purposes of satisfying § 1400Z-2(d)(3)(A)(ii) and § 1397C(b)(2) of the Code, provided that Taxpayer adopts a new or revised working capital plan within 120 days of the end of the qualified disaster incident period satisfying the requirements of § 1.1400Z2(d)-1(d)(3)(v)(A) through (E) of the Regulations and that such plan utilizes the proceeds from the sale of Parcel B (net of any tax distributions) in a manner such that the completion of spending takes into account the originally allowed up to 31-month period and up-to-24 additional month period, as provided by § 1.1400Z2(d)-1(d)(3)(v)(B) Regulations and § 1.1400Z2(d)-1(d)(3)(v)(D) of the Proposed Regulations.

LAW & ANALYSIS

Section 1400Z-2(d)(3) of the Code provides the term qualified opportunity zone business 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, which satisfies the requirements of § 1397C(b)(2), (4) and (8) and which is not described in § 144(c)(6)(B).

Section 1397C(b) sets forth 8 requirements that a corporation or partnership must satisfy to qualify as a 'qualified business entity' and therefore an 'enterprise zone business'. Section 1400Z-2(d)(3) incorporates three of these eight requirements. Sections 1397C(b)(2) and (8) are relevant to this ruling. Section 1397C(b)(2) requires that "at least 50% of the total gross income of such entity is derived from the active conduct of such business." Thus, a QOZB must derive at least 50% of its total gross income from the active conduct of a trade or business within a QOZ. Section 1397C(b)(8) requires that a QOZB hold less than 5% of its aggregate unadjusted bases of the property of such entity is attributable to nonqualified financial property. Section 1397C(e)(1) defines the term nonqualified financial property to mean debt, stock, partnership interests, options, futures contracts, forward contracts, notional principal contracts, annuities and other similar property, however it does not include reasonable amounts of working capital held in cash, cash equivalents, or debt instruments with a term of 18 months or less.

To determine if substantially all of the tangible property owned or leased by the QOZB is qualified opportunity zone business property, § 1.1400Z2(d)-1(d)(2)(i) of the Regulations provides that 'substantially all' means that at least 70% of the QOZB's tangible property owned or leased is qualified opportunity zone business property.

Section 1400Z-2(d)(2)(D) of the Code provides that qualified opportunity zone business property is tangible property used in a trade or business of the QOZB if such property was acquired by the QOZB by purchase (as defined in § 179(d)(2)), after December 31, 2017, and the original use of the property commenced with the QOZB or the QOZB substantially improved the property. Finally, during substantially all of the QOZB's holding period of the property, substantially all of the use of such property was in a QOZ.

Section 1.1400Z2(d)-1(d)(3)(v) of the Regulations provides that solely for purposes of applying § 1397C(e)(1) to the definition of a QOZB, working capital assets are treated as reasonable in amount if the following requirements are satisfied:

A) The amounts are designated in writing for the development of a trade or business in a QOZ, including when appropriate the acquisition, construction and/or substantial improvement of tangible property;

B) There is a written schedule consistent with the ordinary start-up of a trade or business for the expenditure of working capital assets and such assets must be spent within 31 months of the receipt of the assets;

C) The working capital assets are actually used in a manner substantially consistent with the writing and written schedules above;

D) If the QOZB is located in a QOZ within a federally declared disaster, the QOZB may receive not more than an additional 24 months to consume its working capital assets; and

E) A business may benefit from multiple overlapping or sequential applications of the working capital safe harbor, provided that each application independently satisfies all of these requirements.

Section 1.1400Z2(d)-1(d)(3)(v)(D) of the Proposed Regulations modified the existing § 1.1400Z2(d)-1(d)(3)(v)(D) of the Regulations to reflect the need for additional clarification due to the ongoing Covid-19 pandemic. The modification provided flexibility for QOZBs to revise or replace their original written designation and written plan if the QOZB is located in a QOZ within a federally declared disaster, provided that the remaining working capital assets are expended within the original regulatorily required 31-month period, increased by the additional 24 months.

Section 1.1400Z2(d)-1(d)(3)(vi)(A) of the Regulations provides that property described in paragraphs (d)(3)(vi)(B), (C) and (D) of this section may benefit from one or more 31-month periods, for a total of 62 months, in the form of multiple overlapping or a sequential application of the working capital safe harbor period if:

1) Each application independently satisfies all of the requirements in § 1.1400Z2(d)-1(d)(3)(v)(A) through (C) of the Regulations;

2) The working capital assets from an expiring 31-month period were expended in accordance with the requirements of § 1.1400Z2(d)-1(d)(3)(v)(A) through (C) of the Regulations;

3) The subsequent infusions of working capital assets form an integral part of the plan covered by the initial working capital safe harbor period; and

4) Each overlapping or sequential application of the working capital safe harbor includes a substantial amount of working capital assets.

This provision only applies to start-up businesses.

Section 1.1400Z2(d)-1(d)(3)(vi)(B) of the Regulations provides that solely for purposes of applying the 50% test in § 1397C(b)(2) of the Code to the definition of a QOZB in § 1400Z-2(d)(3), if any gross income is derived from property that is treated as a reasonable amount of working capital, then that gross income is counted towards the satisfaction of the 50% test.

Section 1.1400Z2(d)-1(d)(3)(vi)(D)(1) of the Regulations provides for start-up businesses utilizing the working capital safe harbor, if paragraph (d)(3)(v) of this section treats property of an entity that would otherwise be nonqualified financial property as being a reasonable amount of working capital because of compliance with the three requirements of paragraphs (d)(3)(v)(A) through (C) of this section, the entity satisfies the requirements of § 1400Z-2(d)(3)(A)(i) of the Code only during the working capital safe harbor period(s) for which the requirements of paragraphs (d)(3)(v)(A) through (C) of this section are satisfied; however such property is not qualified opportunity zone business property for any purpose.

Section 1.1400Z2(d)-1(d)(3)(vi)(D)(2) of the Regulations provides that tangible property referred to § 1.1400Z2(d)-1(d)(3)(v)(A) is expected to satisfy the requirements of section 1400Z-2(d)(2)(D)(i) of the Code as a result of the planned expenditure of working capital described in § 1.1400Z2(d)-1(d)(3)(v)(A), and is purchased, leased, or improved by the trade or business, pursuant to the written plan for the expenditure of the working capital, then the tangible property is treated as qualified opportunity zone business property satisfying the requirements of § 1400Z-2(d)(2)(D)(i), during that and subsequent working capital periods the property is subject to, for purposes of the 70-percent tangible property standard in § 1400Z-2(d)(3).

Section 1400Z-2(d)(2)(C) of the Code provides that a qualified zone partnership interest means any capital or profits interest in a domestic partnership if, where such interest is acquired by a QOF after December 31, 2017, from a partnership solely in exchange for cash, and as of the time the interest was acquired, such partnership was a QOZB, or in the case of a new partnership, was organized for purposes of being a QOZB, and during substantially all of the QOF's holding period for the interest, such partnership qualified as a QOZB.

Section 1.1400Z2(d)-1(c)(3)(ii)(A) of the Regulations provides that a partnership interest that meets all the requirements to be treated as a qualified opportunity zone partnership interest except for the requirement that the partnership interest is acquired by the QOF after December 31, 2017, from the partnership solely in exchange for cash, is a qualified opportunity zone partnership interest if it is received solely in exchange for a qualified opportunity zone partnership interest in a merger or a consolidation transaction described in § 708(b)(2)(A) of the Code. The other requirements of § 1400Z-2(d)(2)(C) must be met with respect to both the partnership interest held before the transaction and the partnership interest for which it is exchanged in the transaction.

Section 708(b)(2)(A) of the Code provides that in the case of a merger or consolidation of two or more partnerships, the resulting partnership shall be considered the continuation of any merging or consolidating partnership whose members own an interest of more than 50% in the capital or profits of the resulting partnership.

Section 1.1400Z2(d)-1(c)(3)(ii)(B) of the Regulations provides that the requirements of § 1400Z-2(d) of the Code apply to the property of a QOZB acquired from a QOZB in a transaction described in § 708(b)(2)(A) as if the resulting partnership has held the property during the period in which the merging or consolidating partnership held the property. For example, an item of property must be substantially improved by the same date by which the merging or consolidating partnership was required to satisfy the substantial improvement test for such property.

Taxpayer represents that Initial QOZB A and Initial QOZB B qualify as QOZBs. Taxpayer represents that throughout the period beginning with Date 2 and through the merger transaction on Date 6, Initial QOZBs continued to maintain working capital plans and updated written schedules intended to satisfy § 1.1400Z2(d)-1(d)(3)(v) of the Regulations, including on each date of the QOZB testing dates determined to apply between the initial funding date through the merger transaction. Taxpayer further represents that that throughout the post-merger period beginning Date 6 through the date of filing this ruling request, Taxpayer has continued to maintain working capital plans and written schedules intended to satisfy the requirements of § 1.1400Z2(d)-1(d)(3)(v) of the Regulations including on each of the QOZB testing dates determined to apply between the merger date and the filing of this ruling request.

Initial QOZBs were formed with the sole purpose of acquiring Parcel B and Parcel C located in a QOZ, and to develop, construct and operate the newly constructed buildings located on Parcels B and C. They received capital from certain entities certified as QOFs and in exchange, gave the entities a capital partnership interest.

With the capital provided from the first tranche, the Initial QOZBs purchased Parcel B and Parcel C. Parcel B and Parcel C are land parcels located in a QOZ and were purchased from an unrelated third party after December 31, 2017.

Initial QOZB A was merged into Initial QOZB B under state law in a merger transaction described in § 708(b)(2)(A) of the Code on Date 6, with Initial QOZB B surviving, and Initial QOZB B changed its name to Taxpayer. Because of the application of § 708 of the Code, Taxpayer is treated under § 1.1400Z2(d)-1(c)(3)(ii) as retaining its QOZB status for federal income tax purposes, provided it continues to meet the requirements of § 1400Z-2(d)(3) after the merger. Further, because Parcel B and Parcel C were purchased by Initial QOZBs prior to the merger and continued to be owned by the successor partnership, the parcels retain their characterization as qualified opportunity zone business property.

The working capital and written schedules adopted by Taxpayer on Date 10 and Date 11 aggregated and merged the earlier, separate working capital plans adopted by Initial QOZBs with the third working capital plan and written schedules executed by Taxpayer, such that for state law purposes a new aggregate written working capital plan was comprised of three separate, sequential or overlapping plans effective for the post-merger period.

Upon the sale of Parcel B to the unrelated third party, Taxpayer will revise the scope of the Project so that it can be completed within the geographic limitations of Parcel C. These changes will be reflected in a revised working capital plan and written schedules that will be adopted upon the receipt of the sale proceeds or not later than 120 days after the close of the incident period, as defined in 44 C.F.R. 206.32(f), with respect to that disaster. Taxpayer will revise its working capital plans to designate unexpended working capital assets from its three prior plans and aggregate these working capital assets with the net proceeds from the sale of Parcel B into new written plans and expenditure schedules identifying when and how subsequent expenditures would be taken into account while satisfying the requirements of § 1.1400Z2(d)-1(d)(3)(v)(A) through (E) of the Regulations. Each tranche of funding received between Date 2 and Date 8 remains required to be expended within 55 months from the date of receipt and in no case longer than 86 months from the date the first tranche of working capital assets was received.

Parcel B was purchased with capital treated as working capital by Initial QOZB A and was purchased pursuant to the working capital plan and written schedules. Section 1.1400Z2(d)-1(d)(3)(vi)(B) of the Regulations requires that such working capital assets be the origin of the gross income derived for such amount to be counted toward the satisfaction of the active trade or business requirement. Because Parcel B was purchased with working capital assets, the proceeds of the sale of Parcel B may also be treated as working capital assets solely for purposes of satisfying the 50% test in § 1397C(b)(2) of the Code in application to the definition of a QOZB. Further, Taxpayer intends to reinvest these proceeds (net of any tax distributions) and will incorporate the amounts into its revised working capital plans and written schedules, becoming functionally indistinguishable from other working capital assets.

CONCLUSION

Based on the information submitted and the representations given, the following ruling is hereby granted:

The gross income derived by Taxpayer from its sale of Parcel B, which occurs during Taxpayer's start-up period, may be treated as gross income derived from the active conduct of a trade or business in a QOZ for purposes of satisfying § 1400Z-2(d)(3)(A)(ii) and § 1397C(b)(2) of the Code, provided that Taxpayer adopts a new or revised working capital plan within 120 days of the end of the qualified disaster incident period satisfying the requirements of § 1.1400Z2(d)-1(d)(3)(v)(A) through (E) of the

Regulations and that such plan utilizes the proceeds from the sale of Parcel B (net of any tax distributions) in a manner such that the completion of spending takes into account the originally allowed up to 31-month period and up-to-24 additional month period, as provided by § 1.1400Z2(d)-1(d)(3)(v)(B) of the Regulations and § 1.1400Z2(d)-1(d)(3)(v)(D) of the Proposed Regulations.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express no opinion, either express or implied, concerning whether any investments made into the Participating QOFs are qualifying investments as defined in § 1.1400Z2(a)-1(b)(34) of the Regulations or whether the Participating QOFs meet the requirements under § 1400Z-2 of the Code and the Regulations thereunder to be a QOF. Also, we express no opinion on whether any partnership interest held by the Participating QOFs in the Initial QOZBs or Taxpayer qualifies as qualified opportunity zone property, as defined in § 1400Z-2(d)(2). Additionally, we express no opinion on whether Initial QOZB A, Initial QOZB B, or Taxpayer meets the requirements under § 1400Z-2(d)(3) to be QOZBs, or whether their working capital plans meets the safe harbor requirements of § 1.1400Z2(d)-1(d)(3)(v) of the Regulations. Moreover, we express no opinion, either express or implied, concerning any aspect of the merger of Initial QOZB A into QOZB B. Further, we express no opinion regarding the tax treatment of the instant transaction under the provisions of any other sections of the Code or regulations that may be applicable, or regarding the tax treatment of any conditions existing at the time of, or effects resulting from, the instant transaction.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Christina M. Glendening
Senior Counsel, Branch 5
Office of Associate Chief Counsel
(Income Tax & Accounting)

cc: