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"INVESTING IN QUALIFIED OPPORTUNITY FUNDS"
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PROCEEDINGS

(10:04 a.m.)

MS HANLON-BOLTON: Hello, my name is Julie Hanlon-Bolton. I am Special Counsel to the Associate Chief Counsel of the Income Tax and Accounting Division of the Office of Chief Counsel of the IRS.

Today we are here for the public hearing on the proposed regulation investing in qualified opportunity funds, Reg Number 120186-18. This is the second proposed reg on Opportunity Zones and it was published in the Federal Register on May 1.

We appreciate you all coming, traveling to New Carrollton. This is new for us at the Office of Chief Counsel. Most of our public hearings are held in our building downtown. But we had such an overwhelming group, we had a lot of people come for the first NPRM so we thought that we would have it at a much bigger auditorium and this is what New Carrollton holds for us.

So I'm going to start with introductions for the panel. First to my far right we have Shareen Pflanz, she is a Senior Technician Reviewer from IT&A and she will be our clock keeper today. Then we have Sonia Kothari, a general attorney from Passthroughs and Special Industries.

And right to my direct right is Robert Crnkovich, Special Counsel to the Associate Chief Counsel PSI. To my left we have Michael Novey, one of our Treasury representatives on the panel. He is the Associate Legislative Counsel — Associate Tax Legislative Counsel, the Office of Tax Policy with the Department of Treasury.

To his left is Bryan Rimmke who is the Attorney Advisor and another Treasury representative. He is from the same office as Mike, Office of — oh, is it the Office of Tax Legislative Counsel, I'm sorry, Bryan, I have a different Department of Treasury.

MR. NOVEY: We are all —

MS HANLON-BOLTON: All from the Department of Treasury.

MR. NOVEY: All Office of Tax Policy.

MS HANLON-BOLTON:And then down at the far left is Russell Jones who is the Special Counsel to the Associate Chief Counsel for Corporate.

So once again, thank you so much for traveling up here. There is a lot of energy behind this statute. It is a very exciting new area of the tax law and we appreciate all your help to getting the right place for these regulations.

We have reviewed and — all the written comments that have been submitted and we thank you for those comments. Today we have 19 speakers allotted 10 minutes each with possible follow-on questions from our panel. Also, this hearing is being recorded.

So the for all the speakers that are here today, the black box on the lectern will be green while you are speaking. A yellow light will turn on when you have two minutes left and then a red light will come on at exactly 10 minutes. We ask that you stay within your time limit so we don't have to bring out the hook.

(Laughter) That will be Shareen's job.

(Laugher) But we want to hear from everyone who has asked to speak and if we have time at the end we will open up the lights that are out in the audience for anybody else who has comments.

We plan on breaking around noontime for lunch. It depends on where we are at with speakers so but around noontime. You will need — so the lunch room is actually if you go out the doors to where you came in with the security, there is an escalator that takes you up to the next floor and the lunch room is to the left. And you will need escorts to go into the lunchroom. And we have some in the back, in the lobby back there.

Restrooms are out the doors to the auditorium to the left. It's a little hallway to the left and the restrooms are down there.

We will call the speakers up in order on our list of speakers but if there is someone is late or is not in the room we will just put you towards the end so everybody will get to speak if they do come.

And then as a reminder, please put all your cellphones on mute and there is no food or drinks in the auditorium but they are allowing water today because they expect us to go for a pretty long time. OK.

So, Mike, did you want to, do you have some comments?

MR. NOVEY: Yes. First, thank you for sacrificing your time and convenience to come here to help us. As I was walking in down the aisle way, I overhead a couple of people saying that reg hearings like this one really do much better if there were some musical interlude between the speakers (laughter). And I began wondering well, what would be the most appropriate music? And I think from our perspective, it would be that we could get by only with a little help from our friends and in this respect, you all are our friends.

Because you are here to give us some recommendations, I want to start off with a few recommendations about how you can be most helpful to us since clearly that is why you went to the trouble to get here. And this is particularly important in light of Shareen's anticipated draconian employment of the time.

One, we are governed by the language that Congress enacted and the President signed. As a matter of human interest, we understand many people's frustration and disposition with certain aspects of the language that's there. But we are not legislators. And any use of your time to describe how we should do something that really isn't in the statute even if it was consistent with what your perception of the statute's purpose will be interesting but it won't help us to write the regs.

Second, your presence here and your interest in our regulations are all the credentials that you need for us to take your comments seriously. Any more than a one sentence introductory description of yourself and your organization is using up time that would be better spent from our perspective telling us what we ought to do.

Many of your written comments in fact provide very impressive backgrounds and personal CVs and institutional descriptions. We have got those and if you could use your precious 10 minutes to tell us what we ought to do, that's much better. Your being here is enough for us to take you seriously.

And then finally, if you can please try to be concrete. If we should clarify something and I'm sure there are of all the comments that we are getting, I suspect that the largest single comment is please clarify X. Give us an example. Tell us what a clarification would look like.

Even if it's not the best one, even if you could come up with something better than that after a while, it is much better than saying please clarify it and we are left saying well, we knew that. We had but, you know, if we had known how to clarify it we might have done it back in our back room. So if you can be concrete that is one of the most helpful things you can do for us.

Thank you for your time and effort. We are all ears.

MS HANLON-BOLTON: OK. So let's start with the speakers. And I apologize now if I mess nobody's name up but we are going to start with William Cunningham who is representing himself.

MR. CUNNINGHAM: Well, good morning. Is this thing on? Outstanding. So I am Bill Cunningham. I am actually here representing Creative Investment Research which is a company

I have run for about 25 years. If you want to follow along with my comments, go to creativeinvest.com/oz.pdf. Creativeinvest.com/oz.pdf is where this presentation is.

Now I'm going to talk about — I testified at the first hearing that you had. Thank you very much for doing that. By the way, I know this is hard work. I really do. Dealing with the public, I deal with the public all the time. Public is tough to deal with these days, you know. So I appreciate your efforts in this area, especially with a program as important as this.

Now as you know, our concerns are that the Opportunity Zone program seems to allow people with significant capital gains a way to escape their responsibility for paying taxes. And it allows mainly white and wealthy taxpayers to avoid their social responsibility in exchange for investments via qualified opportunity funds in 8,700 poor communities. Mainly black and Hispanic communities.

So our economic analysis leads us to believe that the program is fundamentally unfair and fiscally unsound. We conducted a survey on the Opportunity Zone program to ask a couple of questions. One to find out if people thought that the Opportunity Zone program favored the wealthy, favored the poor, or was neutral.

Based on our survey, 44.74 percent of the people that responded thought that the program favored the wealthy, 5.26 percent concluded that the program favored the poor and 50 percent actually indicated that they thought the program was neutral.

Now in terms of the impact, the social impact, what we do is we create impact investments. That's what we have been doing for the past 25 years. And in terms of the impact, projected impact of the Opportunity Zone on communities, according to our survey, 68.42 percent of the people that responded thought that the Opportunity Zone program would increase gentrification. 10.53 percent thought that it would decrease gentrification and 21.05 percent thought that the program would have no effect on gentrification in those 8,700 communities.

Now, as we testified last time, part of the issue is that the assumptions concerning the Opportunity Zone program are very much like the assumptions that we see being utilized to justify programs that take economic resources out of black and brown communities.

We have seen this most recently with the new introduction of a cryptocurrency called Libra. Facebook is positioning this currency as something that they're going to use to provide banking services to 1.7 — no, look. It's about shareholder wealth maximization. It's about control. So it is with the Opportunity Zone program.

Marketed as a program that's going to bring economic development to black and brown communities. We know. We know based on the history of other programs like the new market tax credit program, like the CRA programs. We know that these programs have a tendency to reduce economic opportunity for black and brown people that were resident in those geographic areas prior to the introduction of these programs.

If you don't believe me, look at 14th Street Northwest, Washington D.C. That's all you have to do.

So we are concerned about the negative externalities that a program like this will impose on black and brown people in the 8,700 communities.

Now we also know that a program like this diverts needed tax revenue from public programs to private purposes. We know that in places like California there is a massive need for investment in infrastructure to deal with climate change. We know that in Illinois there's a need for police and community development in minority communities.

Taking money away from the Federal Treasury will not help these regions provide the service that these communities need. We know that in the state of Texas there is a massive need for integrating new populations into the state. And we know that in New York, there are infrastructure in social needs that are critical especially in light of the reversal of certain private companies from coming into certain parts of the state. I'm talking about Amazon.

Now our suggestions are twofold. The first is, and I understand this may be something that you cannot regulate, but our first suggestion would be that you be very clear that there is to be no benefit to the president, to senators, to congressmen, to state governors, and to others who had a hand in selecting those 8,700 communities. No benefit personally from investments that they hold in those communities.

The second recommendation that we made was that you use something called Ethereum. The Ethereum blockchain. Blockchain technology is basically a distributed public database that is hard to manipulate. That you basically use this new technology to report on Opportunity Zone investment social impact.

And we have outlined an impact measurement strategy that would basically allow you to collect and analyze impact data, to evaluate the data and then to possibly and again this is beyond your capability but what we would like to see is we would like to see the social impact data used to calibrate the tax credit.

You want to put a liquor store in Anacostia using the Opportunity Zone tax credit. The rules say that these types of SIN businesses are not allowed. But we know that the second tranche of the regulations actually provide a safe harbor where there are going to be companies that utilize, that are able to put in SIN businesses in Opportunity Zone communities.

If you don't believe me, there was an Opportunity Zone podcast that I'm happy to send you that outlined exactly how that would work.

So what we would like to see is we would like to see the Opportunity Zone tax credit calibrated to the social impact of the business. So that if you put affordable housing in Anacostia, you should get the entire tax credit. No question about it.

You put a liquor store in Anacostia, you should get five percent of the tax credit. Some type of calibration that measures social impact and reduces or increases the tax benefit accordingly.

Now again, complicated, hard to do but we know that there are certain entities, Beeck Center, Georgetown University. In the interest of full disclosure, I'm a member of the faculty of Georgetown. I had nothing to do with the Beeck Center's social impact methodology as it relates to Opportunity Zones, but I'm simply pointing out that there is one, and it could be utilized to do exactly what I've just suggested in the interest of specificity, I guess.

So, those would be our main recommendations. If you look at the presentation, again, creativeinvest.com/oz.pdf, at the end of the presentation, you will see a social cost calculation mockup — oh, this thing is moving, I don't to want to fall off the stage here — but you'll see social cost mockup that is basically our idea as to how you would take the social impact data from that theory and blockchain that we suggested and put it into a dashboard, that anybody could utilize to see what the social impact of Opportunity Zones investments are.

Now, this is something, again, I don't know how you would regulate that. I really don't, you know, but I know that it's doable. I know that the technology that has been developed now allows you to do things which you could not do 20 years ago. And I'm suggesting you use it for this purpose. So, I think that about covers my comments. Any questions — No, I'm just kidding. Thank you very much. I appreciate your time.

MS HANLON-BOLTON: Thank you, Mr. Cunningham.

Our next speaker is Mary Scott Hardwick, from Opportunity Finance Network.

MS. HARDWICK: Good morning. My name is Mary Scott Hardwick. I work with Opportunity Finance Network, which is a National Trade Association of Community Development Finance Institutions. We have 270 members, and we are CDFI, ourselves as well.

Collectively, our members provided over 65 billion in responsible lending to disinvested communities throughout the country. So, we are excited about the chance for additional capital to flow into these communities but are concerned about whether proper regulations have been written to ensure that the benefits flow through to the communities and to the residents of those communities.

In order to do that, we have three areas that I'm going to cover today, first reporting requirements, anti-fraud and anti-abuse provisions, and then finally ensuring investment in operating businesses.

So first, on the reporting requirements, OFN is supportive of the Opportunity Zones' framework that was developed by the Beeck Center and the U.S. Impact Investing Alliance, and we support transaction level reporting requirements with impact measurements, and making that data publicly available at least once a year.

This will allow communities to see what's going on, what sort of investments are being made, evaluations to be made of the program to ensure that it is worth the tax benefit, or the tax loss that is occurring, and it will allow people to compare zones to see if rural areas are seeing more investments or urban areas, or how the program is working, and where it maybe needs to be tweaked in the future.

We also believe that reporting requirements are one of the best ways to deter fraud and abuse. If people know that they're going to have to submit, you know, transaction-level data, they need to be doing what they're supposed to be doing.

In addition, on the anti-abuse provisions, we have a couple of places that do need to be clarified. The first is the improvements for vacant land when it is acquired. Currently the regulations state that it doesn't need to be substantially improved, but in a different area it talks about how it needs to be more than insubstantially improved, so that's pretty confusing for someone trying to figure that out.

So, for example, we would want to make sure that if somebody acquires 50 acres of land, that they're not putting some small minimally impactful commercial development on a quarter acre and saying that they've improved the land enough.

If you're acquiring large pieces of property, there needs to be a threshold for how much you need to improve it, and having that clarity will help investors move forward.

The conference report that passed with H.R. 1 indicates that certification for funds should be similar to the New Markets Tax Credit Program, and we support that, including adding things that are required in the New Markets Tax Credit Program, such as having fund managers certify that they haven't been convicted of certain financial crimes within the past three years.

We think that's a commonsense check that's already in other Treasury regulations for similar programs, and we would support adding that.

We also suggest extending the ban on SIN businesses, not just for opportunity funds, but to Qualified Opportunity Zone businesses.

Currently a fund can't invest in the SIN business, but the Qualified Opportunity Zones business does not have the same restriction on it, so that creates a loophole for somebody being able to pass through funding there, so we would encourage you to clarify that and make it uniform across the board.

Finally, we are looking for some additional clarity around the reasonable cause for a fund to fail a 90 percent asset test. I think there's concern that, you know, it could be too broad and people would be not making those investments, or if it's too narrow, you would have people who are unwilling to maybe make a riskier investment in a low-income community because they're scared they may fail a 90 percent asset test, if a business plan falls apart, or something like that.

So, it would be very helpful to have clear definitions of reasonable cause is and how a fund would meet that 90 percent requirement.

Finally, we would like to thank Treasury and the IRS for this set of regulations for providing a lot more information about investing and operating businesses. We believe that job creation is the only way that this is going to provide true economic benefit, so we are encouraged that those pieces are in there.

We remember at the Economic Innovations Group Opportunity Zones Working Group, which, they're going to be testifying later, and we support the recommendations in their letter, and we are co-signatory of their letter with recommendations on how to improve it for operating businesses. So, thank you for the opportunity to talk today.

MS HANLON-BOLTON: Do we have any questions? And I apologize because I didn't ask the panel for questions for Mr. Cunningham. So, Mr. Cunningham, we'll wait till the end, and if anybody has a question for him we can ask then. Does anybody have any questions? I have one.

MS. HARDWICK: OK.

MS HANLON-BOLTON: So, your vacant land rule?

MS. HARDWICK: Yes.

MS HANLON-BOLTON: Do you have a number in your head for commercial?

MS. HARDWICK: I don't have a number in my head, but I believe it does need to be more clearly defined.

MR. NOVEY: Excuse me.

MS. HARDWICK: Yes.

MR. NOVEY: If we could come up with it, we would put it in the closet, so — (laughter). The proposal that you mentioned from the — or under certain occasions and there are — for a variety of arcane procedural aspects of certain processes of the statute as it change between that time and the time it's enacted.

But how much time between the submission for certification and receipt certifications that you anticipate would be a horrible delay for all of the Opportunity Zones? And if there were as few as one per zone, we're talking about staffing over 8,700 hands-on certifications. Is that really consistent with the speed and flexibility that comes if the (inaudible)?

MS. HARDWICK: We believe, and from reading the conference report and talking to members on The Hill, that they do support having certification in there. I don't have an exact number for exactly —

MR. NOVEY: And so, how many FTEs personally can get hit?

MS. HARDWICK: I would not know that. I don't.

MR. NOVEY: What I'm saying is, that we also bring that legislative history, and had been said you must send something into an office, and went to CDFI, and you need to wait until a certain issue comes back. And that would have been consistent with the legislative history, it would have been highly problematic with respect to the structure of the statue with its stress on flexibility and (inaudible)?

MS. HARDWICK: I agree that it would take additional resources in order to that, the position of our organization is that it's worth that investment and time.

MR. NOVEY: And so, but with our current resources should we simply slow things down, or it has to be (inaudible)?

MS. HARDWICK: I believe that that the Treasury has found a way to do it with several other programs, and I would encourage you to do as much as you can.

MR. NOVEY: Thanks.

MS. HARDWICK: Mm-hmm. Thank you.

MS HANLON-BOLTON: Thank you. Our next speaker is Kevin Matz from the American College of Trust and Estate Counsel.

MR. MATZ: Good morning. And thank you for the opportunity to speak today. I'm Kevin Matz. I'm a tax trust estates lawyer, and also a CPA. I'm a partner at the Stroock law firm in New York City, and I'm speaking on behalf of the American College of Trust and Estate Counsel, on trust- and estate-specific issues under the proposed regulations.

In our comment letter, we've identified five. Just to move things along I'm going to start with the second one. But just very briefly by way of background, again, we are talking about a trio of benefits, three different benefits to investors by investing in this program.

Number one, they get a chance to defer capital gains, until the earlier two occur according the statute of sale or exchange of the interest in the qualified opportunity fund, again, they have to invest in the qualified ppportunity fund within 180 days of that, or deemed 180 days. Or, the outside date which, December 31, 2026, so sale or exchange, or December 31, 2026, whichever comes first according to the statute, that's the trigger point for an inclusion event.

The second benefit to be derived, so you have tax deferral, you could possibly, through basis adjustments, eliminate up to 15 percent of the capital gain, if you hold the interest in the qualified opportunity fund for five years, you get a 10 percent basis step up, if you hold it for seven years, you get 5 percent on top of that, so that's 15 percent in total that could be eliminated.

And then thirdly, the (inaudible) benefits. If you happen to have the investment of the qualified opportunity fund including tacking by virtue of someone dying, and the like, and you get to 10 years, and their subsequent appreciation value the interest goes up in value, then that appropriation is completely tax free.

So what are some of the issues that are presented in the trust and estate field? I am going to point, because I think that now — I think in terms of trusts and estates means people die and they pay taxes, but they also can make gifts, you could do lifetime transfers.

So what happens if you have a gift and interest in qualified opportunity fund? My thought, when I was reading the statute, was what the statute talks about what's a triggering event, sale or exchange, or December 31, 2026, is a gift to sale exchange? The answer, at least according to the plain and unambiguous language of the statute, I would submit should be null.

It says sale or exchange, and that's what it says under Section 102: A gift or bequest is not a sale or exchange. So, under the Internal Revenue Code plain and unambiguous language, it should not be treated, I would respectfully submit, as a taxable event.

However, under the second tranche proposed regulations that came out on May 1, it is treated as an inclusion event, unless you happen to have a gift, or actually "a contribution" to a special type of trust that is called a grantor trust which is treated as one and the person as the person who makes the contribution for income tax purposes.

Now, I looked at that, I compare it to the statute, it does — very respectfully — it does not square with the statute, and that was noted in the preamble to the proposed regulations, with the proposed regulations, the preambles then said, they went back to the legislative history, the conference report, and in the conference report, it talks about a disposition, and it goes off of the sale and exchange concept.

You'll see that in the comment letter, and this begins the part two, beginning on page 6, we go very meticulously through the conference report, it doesn't evidence an attempt to state, to basically change a very clear precept of the Internal Revenue Code.

Again, I respectfully submit that if Congress wanted to change — wanted to have gifts deemed as sales or exchanges so as to trigger this, they could have done it very easily. They did not. And again, there is nothing that if we look at the entire legislative history and the conference report. Again, I've quoted language verbatim that would suggest that there's some loose language, but then if you viewed in context, it does not show an attempt for expansive reading to override what's in the plain and unambiguous language of the statute. So, that is one point that we would request revision on.

I talked about gifts being an exception, but there's an exception as to the Internal Revenue Code, we love our exceptions to exceptions, and there is a case of — instead of having an outright gift, say, to an individual, I gave it to my son, made a gift to my son, having an interest in qualified opportunity fund which would be a trigger. Again, under the proposed regulations, I would submit should not be the position of the statute.

But if instead I made a gift to a grantor trust, which is a trust that usually I would create, that for tax purposes has certain triggers in it, that cause it to be one and the same as me for income tax purposes, then the proposed regulations correctly state that that is disregarded, and that will not be an inclusion event.

If there's a further distribution from the trust, and it's not by reason of death, that could an inclusion event down the road, but the actual contribution of an interest in the qualified opportunity fund to a grantor trust would not be — would not be bad. I'm following along; this is the third point that begins over on page 10 of the ACTEC Report.

So, what are some of the issues that are raised there? Well, a couple things we need to bear in mind about grantor trust, the number one, the grantor — so being the example, I set up a trust, I retain certain powers, including maybe the power of substitute assets of equivalent value, as a grantor trust triggers section 675(4)(c) of the code.

That allows it to be a grantor trust, and the income that's derived from the assets, including the qualified opportunity fund, they are all taxed to me during my lifetime as a grantor. So that's one benefit. Basically it all flows through.

There's another important provision that needs to be considered, and that is Revenue Ruling 85-13. And that says that if I have a transaction with the grantor trust, let's say I were to sell assets to the grantor trust, it could be one with some interest in the qualified opportunity fund, and I get back cash, or a promissory note, or other property in kind, it's so long, dealing right pocket, left pocket, all of myself, it's a tax nothing for income tax purposes.

Revenue Ruling 85-13 says basically: Across the board it's a tax nothing. I respectfully submit that the proposed regulations should similarly have — or rather, the regulation as finalized, should similarly also state that, so that not only a contribution of an interest in the qualified opportunity fund, and the proposed regulations talk a contribution interest in the preamble talks about a gift, presumably that's one of the same that could be clarified, that would be very helpful.

But if I were to have other transactions that were within the purview of 85-13, basically anything during my lifetime, while it's a grantor trust, it could be a sale, it could be a swap of assets, it could be a distribution, including in kind, that should not be an inclusion event, and it seems to be consistent with the intent here, but that needs to be clarified.

Importantly, because a grantor trust also is treated as one and the same as me, it should not matter if the source of funds that are used to go to the qualified opportunity funds, come from the grantor trust, or come from me directly. Again, Revenue Ruling 85-13, the grantor trust provision 671 through 679 of the code, treated as one and the same, and therefore that should be respected all the way across the board here.

Now what are some of the other issues? I'm going to point four, which is page 11. Here are some items to consider. There were, in the proposed regulations that came out, actually the first tranche that came out last year, very helpful relief provisions to the 180 date rule, that's basically the rule that says: if you have a capital gain, you have 180 days to invest in the qualified opportunity fund, if you don't, you lose the opportunity to defer and have possible basis adjustments, and then after 10 years, if there's appreciation, be able to avoid tax on that, on the gain.

That's very helpful. Where this could be problematic, let's say, and the worst of relief provisions, so one relief provision is that if I have to be a partner in a partnership, instead of looking at the partnership, unless an election is made to the contrary, it could be the partner who then has the ability to defer the gain, because a partner gets on it anyway based on by receiving a K-1, and then unless an election is made otherwise, it's the end of the tax year that's used for 180-day period to start. So that would be in most cases — in many cases December 31.

So I could have had — the partnership could have had the sale occur February last year, well over a year ago, but because it was a partnership, and because an election was made otherwise, December 31, 2018, could have been the trigger date to start the hundred day clock and as long as the investment was made by June 29th of this year, it would qualify. What are some of the issues that arise partnerships, S corporations and also apply to trusts and estates? This is dependent on effective communication between effectively the fiduciary, the manager and the beneficiary or partner or S corporation shareholder. And the communication device is the K-1. And that works wonderfully if the tax returns are filed properly, the K-1s are issued properly and then all that gets shared.

But that's not how the real world often works. Quite often, especially with any measure of complexity, quite often with partnerships, S corporations, and also trusts and estates, returns go on extension. And if return's on extension, you're talking about due dates in September, October for the K-1 to even have to issue. And by the time the partner or S corporation shareholder or beneficiary of the trust or estate gets the K-1, low and behold and you'll see as described in the example that provide in the materials, it could well be September. And at that point, they're completely out of luck because they're more than 180 days out from the window.

So, our proposal here is that just as there was relief provided for the 180 day situation in the case of partnerships that in order to achieve the objectives here of substantial economic investment, in economically stressed communities — i.e., Opportunity Zones — the capital gains and the funding mechanism. There should be an allowance here that says the 180 period runs from the later of the 180 day period under the proposed regulations. Or if later, 180 days from the filing of the time they filed, including extensions for the tax return that issued the K-1.

My time is very short, just a couple of brief points. Basis adjustments, what happens upon death. Under section 691 which is incorporated by reference here, there is no step up in basis. However, you'll see and this is.5, if however, there is appreciation value through date of death, that is not an amount that is recognized under the section pursuant to the language of the statute. Therefore, that amount should not be tied to 691 which basically carries over the deferred gain to the person who happens to be holding onto the investment at the time of recognition event such as December 31, 2026. And that amount through date of death should be subject to step up and basis.

And then just the last point, 15 seconds and I see that I'm out of time. What happens to an inheritance where someone inherits an interest and qualified opportunity fund and low and behold, they have nothing to pay the tax and come December 31, 2026, request relief. Thank you for your time and attention.

MS HANLON-BOLTON: Thank you, Mr. Matz. Panel, do we have any comments or questions?

MR. NOVEY: Do you see in the code any mechanisms or —

MR. MATZ: I'm sorry I didn't catch that.

MR. NOVEY: You suggested that gift should not count as an inclusion event.

MR. MATZ: Yes.

MR. NOVEY: Are you suggesting that the sale or exchange by the donee would trigger a tax liability for the donor if the donor happens to know of it? Or are you suggesting that the sale or exchange by the donee triggers liability for the donors to start capital gains?

MR. MATZ: Well, I think the better reason result here should be that the donee upon receiving it, unless we have a grant or trust. So, a grant or trust would be completely different. Let's say I'm making a gift to my son.

MR. NOVEY: Yeah. I'm talking about not a grant or trust.

MR. MATZ: OK. In that case, the sale or exchange by the donee should trigger a tax to the donee. That, I think, is a better reason.

MR. NOVEY: And if the donee sells and let's say hypothetically that, you know, the donee may have some gain because of the basis (inaudible). But you were saying that the donee then picks up the start gain by the donor.

MR. MATZ: Right. And that would be consistent with how ordinary principles work.

MR. NOVEY: In my opinion, that might be very reasonable — but do you think that a donee who says I don't see any obligation on my part. I don't get it. I don't owe anything for gains that my kind uncle may have diverged before I was born.

MR. MATZ: Well, in that case, the donee has an obligation enforceable by the Internal Revenue Service. Well, if the donee has property and it has zero basis perhaps or maybe an adjustment basis over the course of time but putting that aside. So, the zero basis and it sells it, it has a gain. It has a capital gain, presumably that then will trigger tax costs closest to the donee and the donee fails to pay it, that is tax evasion.

MR. NOVEY: And if the donee has losses, then so be it, the donor (inaudible)?

MR. MATZ: Well, that is a situation that applies right now. So, it could be that donor has a capital gain, doesn't make a transfer or an individual's capital gain does not make a gift to a donee. And then in a year prior to 2026 has losses, sells the interest to the qualified opportunity fund then and then is basically to have zero tax. So, that is no change from the current situation that exists.

MR. NOVEY: In terms of clarifying that the tax nothing attribute of the grant or trust that are reflected, is there anything in the current proposed regulations where you see an implication that we would fail to reflect (inaudible).

MR. MATZ: Again, that's an excellent point. I don't see anything that necessarily cuts away at it but it isn't addressed and therefore it would be very helpful to clarify it because —

MR. NOVEY: There are lots of obvious consequences of current law that we don't address.

MR. MATZ: That is true. But it could be that maybe simply an example to say that if there's a sale, take back the promissory note, that is governed by revenue rule 85-13 and therefore it effectively is the same as though it were a gift because it's a tax.

MR. NOVEY: Finally, you raised the point in your comments that the IRD rate put the beneficiary in the posture of having tax liability for which it has no tax (inaudible). Are you suggesting something more like a — as an automatic with underpayment interest extension of the liability pay? So, that the liability can be measured at an appropriate time but there would be recognition of the fact of the persons liable for the IRD ought to get some temporal relief that would effectively be made whole.

MR. MATZ: That is an excellent suggestion. If some relief is needed because any time you plan right now basically you almost have to plan with life insurance. You know, you have to talk about that which means then you have to have this additional set up and reputable life insurance trust to make it tax efficient. And then you have to match the trustee and the beneficiaries to whoever has the interest and qualified opportunity fund.

There's a lot to take in account. Some sort of relief is needed and I do completely understand your point that, well, the statute says that and how far can you go beyond the statute. But if there's some sort of relief provided, installment payment plan and that could be administratively built and that would go a long way to addressing this concern. Thank you.

MS HANLON-BOLTON: Thank you. All right, our next speaker is James Rose from the Rose Development, LLC.

MR. ROSE: Hello and thank you, it's great to be here. I was here at the first hearing back in February that was going to be in January and I was here with my wife. And the reason why we were here back then was that we are, I'm not a — I am a developer, I'm not an attorney, I'm not an accountant and I'm also partners with the State of Utah in some of my developments.

And one day, I'm having one of my partnership meetings and the director walks in with this letter from the Governor nominating 47 census tracts and says can you look this up and tell me what is this, you know. And it was the first time I'd ever heard of anything like that. It was in about April or about June 1 and boy this has really changed things for us.

Because at first, I was like well what the heck, where's the map that shows me where these census tracts are. So, I can understand what properties that we have with the State of Utah that we're developing and giving a large portion of the money to the students, you know, whether or not these developments are inside an Opportunity Zone.

And so, it really sent us down a certain path. Then we decided well, we better, once we figured out that it had to go through a fund and then it had to go to, you know, go through all the regulations and the processes we decided we better do a fund. Well, then it was like well we need to find an attorney that knows this and can help us do this the right way. So, we drafted a set of documents and we found out that there were going to be these regulations, these guidance comments and what not.

So, here is the first and second regs right here, right? First one came out in October. It was about 73 pages and it set us back because we thought well there are really so many issues not being an attorney, not being an accountant that I didn't even know were possible issues in the first place. I mean, we're developers. I'm a licensed general contractor. I was a licensed general contractor, builder, in the state of Utah when I got my license. I'm also a principle broker in Utah and in Nevada. So, I know a lot about transactions as it comes to real estate, building and doing things like that.

So, this process that we've been going through has kind of led us to the point where we're thinking, all right how do we take something so complicated and make it simple for us to really be able to use. And for us to be able to explain to our friends and for my wife and I to do our family planning with for the next, until 2047.

And so, one of the funny things that happened to us is that on December 7, 2017, my wife and I closed on about 20 assets in an Opportunity Zone for the purpose of improving these assets, you know, for the community and doing exactly what the law really helps developers do. But we did it about 20 days too soon, right? So, we understand how important it is to know all the little nuances of this law.

So, what we want to do is make it as simple as possible in the big ways for when people can — so that normal people can understand and verify what fund managers, now we're fund managers, right, we're not just developers and builders. Now all of the sudden, we have to manage a fund, we're fund manager for our own projects. So, that when we talk to other people as fund managers that they can get the information without having to hire a bunch of accountants and attorneys for just the big concepts.

And that's why I wrote all my comments about the IRS website, HYPERLINK "http://www.irs.gov/" \h www.irs.gov. And it's a wonderful resource and tool. I think it could be updated a little bit. You know, we have these regs that have been coming out and there's some really great things that haven't kind of transferred over onto the website that I think could happen. And there could be more of the kind of, you know, Opportunity Zones for dummies kind of sections, right? And it kind of gets into —

SPEAKER: Maybe Opportunity Zones for real people, right?

MR. ROSE: Yeah. Yeah because sometimes we feel like dummies when we're kind of going through this. You know, I like to print things off and I've been printing off everything that you've been, you know, submitting and writing to us and cross reference it and, you know, trying to figure it all out. And some of the things, you know, we should be able to rely on as normal people. And some of the things year, we might need to, you know, get our attorneys to give us an opinion letter on. But there should be parts that we don't have to do that for.

And so, one of the things that I noticed on the website recently because I went back to check before all of this came, was that in the frequently asked questions page on Opportunity Zones, there should be more detail and clarification given as to what is a qualified opportunity fund. Currently, the FAQ page answers the question, what is a qualified opportunity fund, with an answer indicating that it is a vehicle for investing in eligible property located in a Qualified Opportunity Zone.

For someone unfamiliar with the act, the stated answer could be interpreted as only including real property located within an Opportunity Zone. This interpretation would miss an additional major benefit of the act which is the investment in Qualified Opportunity Zone businesses. And given the potential for growth and positive impact that QOZB's can bring to Opportunity Zones is benefit of the act should be more clearly stated in the answer.

So, as somebody from my local community of Utah where we have 47 zones and my current office was located by some luck inside of an Opportunity Zone, I look at this and I start speaking to people about it. And all of the sudden they start looking at me in my local community like I'm some kind of an expert. And so, I keep saying, listen, I am not an expert in this but I am the guy that just recently held the first stakeholders meeting in my community with the mayors of my communities and the city council members and so on and so forth. And not one of them knew hardly anything about this and the misconceptions were just unbelievable.

So, articles have come out and people have started calling me and I'm sitting here thinking how can we make this the most reliable for everyone. And that is pointing back to the IRS website. We could have these, you know, little bit better pieces of clarification that people can go and fact check what others are telling them. Whether it's their attorney's or whoever it might be.

And then I reluctantly bring this last part up which is just about the act itself. I know that you don't want to really hear that but as we have gone through different revisions of PPMs or, you know, private placement memorandums if there's anybody else out there like me that may have never been to these things before. We have had revision after revision based off of the guidelines.

But when we look at raising additional funds from people, you know, we can only right now bring in tax advantage or deferred capital gains money. And I know that you have to change the act and we're not here to do that, OK, the law. But wherein you have latitude to kind of make exceptions or create possibilities where some of the people that call me that want to move their businesses into these zones that want to do kind of like 10-year planning.

If it's something that you can do where, you know, the part where if they leave their money in there for 10 years, you know, and there's capital gains. It shouldn't really matter, that's my big point, whether that money came from capital gains. If they're willing to go through all the rules, yeah, they're not going to get an increase in basis, none of that applies to them. But they should be able to get some of those benefits and I don't know all the ways in which you could make that possible where there could be. Hey, they're leaving their money in those funds in the fund for 10 years and the fund then is investing in QOZB's or QOZBP's properties, project.

And if you're not able to in some way make that happen so that that money can be tax advantaged, then perhaps as we are selling or making money capital gains in our QOZBs and then we're sending that money back up to our QOF's, right, our qualified opportunity funds. Then maybe there's something that we can do that clarifies the ability to take those capital — some of that money somehow. I mean, I don't know where the latitude is here but it would be extremely helpful.

But either way, the simpler we can make this and one other point about the IRS website. If you could even have a little section that said, if you were a QOZB, a business and you want to do a QOZB, here are the one, two, threes. Or like a checklist of ten things that you need to start off with, that would be incredibly helpful. That's it, that's all I had to say.

MS HANLON-BOLTON: Any questions for Mr. Rose?

MR. NOVEY: Just one in terms of sharing your predilection for printing stuff out and then coming across something that is in need of clarification. When I printed your hearing outline, I came across 1K3-9LAY-BB67 and then something else as well with a similar (inaudible). It's comments that you say you had submitted before but I wasn't smart enough to figure out what timeframe.

SPEAKER: PRN1.

MR. ROSE: You know and —

MR. NOVEY: We would love to see them.

MR. ROSE: I apologize for that. And there again, this is my first time ever getting involved in something like this or the hearing, but thank you.

MR. NOVEY: But, you know, I saw the summary of what you said.

MR. ROSE: Yes.

MR. NOVEY: And some of it was, as you recognize, in addition to —

MR. ROSE: Outside.

MR. NOVEY: — alerting us to your frustrations, which we also have some frustrations. You may want to communicate that to the people who actually can change the law. But in addition, since you made those comments and want us to prevent it (inaudible).

MR. ROSE: Absolutely. There was a clerical error there. I thought that was —

MR. NOVEY: No problem.

MR. ROSE: Thank you for bringing that to my attention.

MR. NOVEY: Do you know how many clerical errors I make?

MR. ROSE: Thank you.

MS HANLON-BOLTON: Thank you very much. Our next speaker is Fran Seegull, U.S. Impact Investing Alliance.

MS. SEEGULL: Good morning, folks. Great to see many of you again. I'm Fran Seegull, Executive Director of the U.S. Impact Investing Alliance.

So, the U.S. Impact Investing Alliance and our members represent collectively about a thousand private investors and financial intermediaries who are actively engaged in deploying private capital to advance the public good. We believe in leveraging the power of markets to create measurable social, economic, and environmental benefits and that investors can play an important role in achieving desirable policy outcomes. Many of our members and our stakeholders have particularly deep knowledge of and track record in investing for community economic development. They include institutional investors, foundations, pension funds, university endowments, high net worth individuals, banks, and community development finance institutions that understand the importance of place, local contacts, and authentic community engagement when investing in low-income communities. For this reason, we have taken a keen interest in opportunity funds, Opportunity Zones, and the development of pertinent regulations, but it's based on consultation with these members that I offer the testimony to you today.

In previous comments before you and in several iterations of written comments, we have underscored the critical importance of timely, accurate, and consistent data collection and reporting. We believe that of the remaining issues to be addressed by Treasury in its rulemaking, this is perhaps the most important. It's certainly the most important to us and the members that we represent.

We are heartened to see that Treasury released a request for information on data collection and tracking and Opportunity Zones and we're likewise glad to see that this issue has been taken up by the White House Opportunity and Revitalization Council. We are grateful to those of you here today and your colleagues throughout the Administration for their efforts to elevate this topic of impact accountability and community engagement. Before I address data and reporting requirements, I'd like to first quickly address the issue of rules to prevent abuse.

It was encouraging that the Notice of Proposed Rulemaking included broad authority to recharacterize abuse of transactions as nonqualifying. In final regulations we recommend that Treasury should seek to provide greater clarity about the circumstances in which this authority may be exercised. qualified opportunity funds are given great flexibility in deploying capital in Opportunity Zones.

The authors of the statute were clear in their goal to see a broad range of operating businesses and other investments supported to meet the needs of Qualified Opportunity Zones. Treasury in particular with the latest proposed regulation has approached the rulemaking process in a manner consistent with this intent, but this flexibility also creates significant room for abuse. It would be impractical to enumerate every type of potential abuse. In our written comments, we articulate a three-part approach to this topic.

First, in final rules, the IRS Commissioner should maintain the broad authority to recharacterize abuse of investments as such. Second, Treasury should define some clear potential abuse of action such as land banking to immediately prevent such predictable negative outcomes. And third, Treasury should consider the adoption of a safe harbor such as independent certification of the community benefit practices of opportunity funds to provide investors with an additional degree of certainty that their investments are being well managed and do not violate these abuse rules.

We provide greater detail on all points of this approach in our written comments, but on this last point, I would like to underscore that the private sector tools needed to implement independent certification are already under development. Several speakers already mentioned this Opportunity Zone's reporting framework is a private sector standard for reporting that was developed by our organization, the U.S. Impact Investing Alliance, in partnership with the New York Federal Reserve Bank and the Beeck Center at Georgetown.

So, a broad range of groups including us have worked to develop these frameworks, tools, and methodologies that could be used as a basis for an independent certification program. With a safe harbor tied to independent certification, we believe that significant numbers of opportunity fund managers would be incentivized to voluntarily take part. We believe that with sufficient participation, these market-led efforts would become financially viable, these certification efforts. Standards would need to be instituted for which certifications qualify for safe harbor protection, and these certifications would need to be continuously monitored over the course of the program. We believe that the CDFI Fund would be naturally suited to handling this task, given their experience managing other effective community development programs.

As discussed in my introduction, I want to spend the balance of my time on the vital importance of tracking and publicly reporting on fund and transaction level data about Opportunity Zone investments. The Opportunity Zones market cannot function efficiently without access to basic transaction data about qualified opportunity funds and their investments. For this reason, we recommend the Treasury collect and report publicly on basic fund and transaction level data about qualified opportunity fund activities in a consistent and timely manner. Doing so would achieve the goal of tracking the effectiveness of the policy and create multiple benefits directly increasing that effectiveness. While we applaud Treasury for its thoughtful RFI on this topic, the time lag in aggregated data envisioned in that document would be entirely insufficient to assess the efficacy of the policy.

Fund and transaction level reporting should be collected in a manner other than through a tax form, likely through a web portal, and the information should be made available to the public in a disaggregated, anonymized, and timely fashion. Such reporting would not create a meaningful burden on qualified opportunity fund managers. And the public benefit of such reporting was articulated in a wide range of public comments submitted to Treasury to its RFI on the topic.

The statutory language creating Opportunity Zones gives Treasury the necessary authority to collect and report basic fund and transaction data. Collection of this data will enable qualified opportunity fund managers to track and certify their compliance with the statute. The Secretary is given the specific authority to promulgate regulations to facility the certification of qualified opportunity funds.

Furthermore, while we primarily see this data collection effort as a means to promote the efficient formation and deployment of capital, an ancillary benefit would be to inform Treasury in promulgating and enforcing rules to prevent abuse, another point on which the Secretary has specific authority to institute reporting requirements.

Finally, Treasury has repeatedly and clearly articulated that the purpose of the statute is to promote economic activity in Opportunity Zones. This intent is further supported by the statutory language and legislative history of Regulation 1400(c). In previous written comments, we have discussed at length the benefits that basic and transparent reporting will have for market participation.

To quickly summarize this point, reporting will increase investor confidence, enable more efficient capital matching, and promote effective partnership with state and local governments. Again, the Secretary is given broad authority to promulgate rules that advance this legislative purpose and could under that authority institute reporting requirements. Such a reporting process would require a minimum level of staffing within Treasury to implement reporting, ensure completeness and accuracy of data, and prepare reports.

The CDFI Fund provides a model through its role in implementing and overseeing the new markets tax credits program, and we suggest that the Secretary consider leveraging this existing resource to support implementation of Opportunity Zones' reporting requirements.

Thank you once more for the opportunity to testify. We've remained deeply optimistic that once these remaining points are clarified, this policy can be used to improve the lives of the 32 million residents living in Opportunity Zones today. The taxpayers of this country have made and will make a tremendous investment in the economic potential of Opportunity Zones. I urge you here today to give us the tools we need to measure and affirm the impact of those investments. Thank you.

MS HANLON-BOLTON: Thank you. Does anybody on the panel have a question?

MR. NOVEY: It would help even if was not an exhaustive list to give some examples of abuses you think we ought to write into the regs and, in particular, what the consequences of those abuses ought to be for either the fund or the ultimate (inaudible) the business, the fund, or the investors.

MS. SEEGULL: So specific examples of —

MR. NOVEY: The IRS and Treasury are not bashful about being concerned about abuse, but (inaudible). You referred to the importance of providing for independent certification, essentially of consistency with the legislative history as articulation of the purpose. There's a variety of questions related in part to who would do this. Would such certification be conclusory? In other words, you've got private actors. You've got a lot of money involved. It would not be unheard of for an otherwise magnificent independent force to get captured by the transactional process, a fascinating podcast by Michael Lewis (phonetic) (inaudible).

So, would a positive response be absolutely exclusory that IRS could not get behind it to say we don't think that this was a fair (inaudible)? What consequence of failure there ought to be done? And are you imagining ab appeal process for someone who says I should have gotten my certification and you didn't give it to me? And it may have been negligence. It may have been a difference in judgment. It may have been corrupt. But it would be unusual and possibly inappropriate for some private actor, absent statutory delegation and responsibility, to get this kind of control over whether or not a taxpayer gets the benefits that the taxpayer thinks it is entitled to.

In terms of the transaction and the transaction tracking, you said that, well, this isn't going to be collected by the IRS and implicitly seemed to suggest that, therefore, it would not be subject to the privacy assurances in Section 6103 (inaudible) numbers instead of concepts. And I'm not sure that this would get the kind of granular analysis that you're suggesting be made public, so you're looking to whether or not that kind of granular information would be collected for government evaluation of what's going on. But making that kind of granular analysis public, even if, as you put it, anonymized, but is aggregated, if there is a transaction that is described and it was in a census tract (inaudible), and there is only one fund operating a census tract there, being anonymized doesn't do much good. And so I think the privacy issues are important.

Then finally, lacking explicit statutory mandate, you said it was written for authority, but not the statute, suppose somebody says I don't feel like filing this information, what are the consequences? Should the IRS enforce filing by denying the tax benefits? Should the filing be done (inaudible) under penalty of perjury? I think the general desirability of taking a tax incentive, which is as inviting, sort of you all come, as this one is, with no aggregate limit on the amount of (inaudible) that would be possible, some people can take up (inaudible), the risk that all of the problems that Mr. Cunningham identified that might come true are there, but take concrete steps to ensure that what Congress says it wanted, it gets, are not simple or automatic.

MS. SEEGULL: OK. I'll do my best to answer those. I wish I had taken my pen up here. I'll do my best and am happy to take some of this offline.

MR. NOVEY: (inaudible).

MS HANLON-BOLTON: Yeah, I second the examples for abusive transactions.

MS. SEEGULL: OK. So, just as kind of a high level thought, we believe and we're also part of the EIG coalition and Novogradac coalition and our members feel that in exchange for the tax advantage capital that Opportunity Zones represents, that the disclosure so that we can ascertain the efficacy of the policy is a very reasonable trade.

MS HANLON-BOLTON: Well, to that, you need to go somewhere else because that's not in the statute at this point.

MS. SEEGULL: Understood. Understood. And someone else mentioned that reporting was stripped out of the statutory language for parliamentary reasons, and we're aware of that. I'm not able to speak about live legislation because I'm not allowed to lobby, so I won't opine on that topic here, nor is it appropriate in this forum, but I'm just saying what our members believe.

So, what we are communicating in a testimony is two pieces around data. One is fund and transaction level data disclosed to a central data repository and then available to state, local, federal governments, policymakers, academics, as a way for us to ascertain whether the Opportunity Zone benefit has been efficacious, and again, our belief is community economic development is a desired result.

And so, what we envision there, and I'll get to this piece about certification and rules to prevent abuse in a moment, but what we asked for actually in our first public comment letter, and I testified on this on Valentine's Day earlier this year, we're asking for capital raised into an opportunity fund, property acquired, amount invested in each deal and deed, location by census tract, NAICS code sharing the business type, so that we can start understanding — and we actually asked for additional information, including jobs creation, percentage of units affordable where appropriate, new business starts, business ownership type with a special focus on women and minority entrepreneurs, and poverty reduction, which many folks believe that that is an outcome that should not be — that would be burdensome on the fund manager, and so we threw that in there, but I think that it's really important throughout all of these discussions around data to understand what is appropriate use and request of fund managers and what is best analyzed by policymakers and academics and think tanks.

And so there, what we're envisioning is discloser through a web portal similar to the one that is used by the CDFI Fund to administer new markets tax credits. I take your point about privacy and if, you know, there is, indeed, one investment and one Opportunity Zone that is problematic, but we still believe that — what was suggested in the RFI from Treasury was single numbers, complete, kind of programmatic aggregation issued, you know, every handful of years and we feel like that is insufficient. So that's kind of one topic and I'll try to wrap it up. I see we have a time constraint.

On the issues of rules to prevent abuse there what we're asking for is a certification of safe harbor saying that if you use a third party certifier, indeed, a private sector certifier — those certifiers which would be certified by, say, the CDFI Fund and some kind of interagency agreement in the same way that there was an interagency agreement between the IRS and the CDFI Fund and certifying the 8,700 Opportunity Zones.

And so, you know, [we] asked the representative from Opportunity Finance Network about this issue of certification. What we're asking here around the rules to prevent abuse, the safe harbor, a certification program where, say, a CDFI Fund would certify the certifiers, so there wouldn't be — need to be a certifier and, you know, just your point, your question to OFN earlier today. So that's sort of what we imagine.

I'm happy to disclose in writing answers to some of your other questions if you feel that I don't have time to answer them at this time. I see you're wanting to move on. OK. Well, thank you —

MS HANLON-BOLTON: We would like to hear from you, but we have a lot of speakers.

MR. NOVEY: One thing to add and that is when you do a lot of people have criticized the selection by governors. In some cases, census tracts that were gentrified, and by the time — in fact, gentrified by the time the governors made the designations. And are you suggesting that there will be some impairment of investors that don't always go into those tracts because there really is little social benefit derived particularly from the loss of tax revenue?

MS. SEEGULL: The Urban Institute did a report, as you probably saw, that showed 3 to 4 percent of census tracts that were selected or have experienced gentrification so it's still a relatively small percentage, but we know it's a concern. So I'll look forward to following up with greater details and examples in a written format.

MR. NOVEY: It may be more than 3 to 4 percent —

MS. SEEGULL: Yeah.

MR. NOVEY: — of the total investment.

MS. SEEGULL: Pardon?

MR. NOVEY: It may be more than 3 to 4 percent of the total investment.

MS. SEEGULL: Yes, yes. Understood. Well, thank you. Thank you very much.

MS HANLON-BOLTON: Well, thank you very much. We appreciate it. OK. Our next speaker is Steve Glitman. He is from Develop LLC.

MR. GLICKMAN: Thank you to the panel for having me back to testify. I was here in February testifying on the first round of regulations. I will be complementary on the second round, but I will also have a number of issues in line with the first round of regulations which just take as constructive criticism and nothing more, nothing less.

My name is Steve Glickman. I'm the founder and CEO of Develop LLC, between 2013 - 2018 I was the founder and CEO of the Economic Innovation Group, co-founder along with Sean Parker and John Lattieri which was deeply involved with the architecture behind the Opportunity Zone program. Over the past year I've spent most of my time in and around the country talking, working with opportunity' zone fund managers, with wealth managers, with community leaders, with Opportunity Zone businesses and developers and others trying to educate various parts of the country and various industries about the program and how it works. And working with individual client as they attempt to utilize the program.

And so a lot of these comments are built along in the spirit of how is the market practically responding to some aspects of this and where do I think there may be some easy areas for the IRS in finalizing these rules to make this more workable along the intent of the program which is, one, to raise a transformative amount of capital for Opportunity Zone communities, and being able to do that through various types of fund structures. And also to ensure that the deployment of the funds go both to operating businesses, as well as real estate of all types, and I'll get to how a few of those pieces, I think, are playing out.

I'm a member of the EIG Opportunity Zone coalition and the Novagratic working group and I think both they, along with the ABA, have put together very thorough and excellent jobs at providing a very detailed look at the regulations with the recommendations that are broadly, I think, consistent with each other and overlapping which I think is a good sign that the market's coalescing around where it needs.

I think there are two big categories I want to point out. One relates to the formation of multi-asset funds, and one relates to the utilization of Opportunity Zones for operating businesses. And there's a few issues within there that I think the IRS needs to be more [clear] on before finalizing.

The most important, I think, aspect for multi-asset funds is actually a very easy one. I think the IRS did a good job in the regulations in April of outlining an exit strategy for single assets, single asset exits out of multi-assets funds. And there's, I know, some commentary around different ways to structure it, but the far more important, I think, issue right now is that it's the only part of the regs, really, that the IRS left open to speculation from the investor community in saying that's the only part of the regulations that investors and fund managers can't rely on.

And the impact of that, I think, is quite substantial. While there are multi-asset funds in the market it's not unreasonable as a multi-asset fund manager when having to address questions from investors to be concerned with the fact that they don't have a good answer as to why that part of the statute hasn't been allowed or why investors haven't been instructed they can rely on that part of the statute.

My sense is that [the] IRS assumed that this would be an issue that fund managers wouldn't have to address until much later on in their life cycle because many of these funds were structured to exit 10 years or beyond. The reality is the structure decisions are being made right now. And without the clarity that you can exit single assets without a tax event, investors are much more hesitant to invest in those funds and I think you're seeing that in the fund raising. I think multi-asset funds, while some are having success, many are facing a slower fundraising cycle than they expected, in part because of this feature of the regulations.

So I think even before the full finalization of the regulations for Treasury to put out an additional amendment or an additional piece of regulation to make clear that the existing rules can be relied up, and, of course, the IRS can change its mind or clarify further in finalizing the structure. It would do a part into getting more capital into the market.

One piece though of the multi-asset fund structure that I think has created some questions in the market relates to depreciation recapture. Right now it's fairly clear that exiting out a single asset or multi-asset real estate funds and a single asset basis you would avoid depreciation recapture because it would be treated as the capital gains and the regs made clear that single asset exits would not be subject to capital gains. But if you're exiting out of, let's say, a renewable energy vehicle where you're selling assets that would be treated as the sale of personal property and that's ordinary income out of a multi-asset fund it reads right now as if the tax treatment would be different, and you would be subject to a tax event unless you organize those assets into single asset funds.

And, of course, that's possible to do, but quite cumbersome if the goal is to get — aggregate a lot of capital for, in this case, a renewable energy asset class or other, sort of, business assets classes within these zones. There's no policy reason why you should be treating real estate, let's say, different from renewable energy, and no reason you should have to enter into an exotic structure if you're structuring nonreal estate multi-asset funds in order to get the same benefit, which is to avoid depreciation recapture at this sale of individual assets after 10 years.

The third piece I'd say is a little more controversial, but I think important, and after the October regulations the Treasury and IRS made clear that there were three eligible classes of investments that Opportunity Zone funds could make. They could make equity investments, they could have preferred equity interest, preferred equity interest and special allocations. Special allocations, I think, was read as much of the market is allowing for carried interest to receive the Opportunity Zone fund treatment. And in the April regulations the IRS made clear that for any interests that are not a purchase from an investment in the fund as opposed to treated to by sweat out equity in the allocation that those type of interests would be treated differently.

And I understand the rationale for it, but I think it carries some unintended consequences. One of which is, I think, you limit the number of professional fund managers who are going to engage in the marketplace. As a fund manager the primary benefit of this program is creating ease of capital raising, and for a lot of fund managers that's important. For professional and other institutional fund managers, I think it's much less important. And not being able to tap into the Opportunity Zone benefit I think will limit the amount of those type of fund managers we have in the market which I would argue is important given, as we've all seen, the complications of or the complexity of the program and the rules involved, and the shared desire we all have to ensure these funds meet their intended purposes.

But maybe the far more important issue is that it's starting to create, as I'm observing, a fundamental misalignment between fund managers and LPs. And that especially occurs in the case of opportunity style real estate funds where much of the value is derived in the first years of the construction or rehabilitation, and once you have stabilization you start to have a diminishing return on those funds. That creates an enormous amount of pressure for fund managers to sell well before the 10-year mark. They may feel they have a fiduciary responsibility because they can meet the — they can receive at the highest price, you know, five or six or seven years into the marketplace when investors, you know, have a tax reason to stay in and ensure they can stay invested in that asset for 10 years or more.

And there's no reason to have that misalignment. I'd argue with the carried interest treatment that was originally envisioned in the October regulations, it would create a natural alignment to ensure we have long term 10 year plus investments in these funds where you don't then have this artificial misalignment between the length of time in LP, which is to say invested in the fund, and like the time at GP is incentivized to manage that capital.

On the operating business side I think there's some much more fundamental questions. The most important relates to how we treat the substantial improvement test and whether we are looking at it asset by asset or as an aggregate basis. It's fundamentally not practical to invest in an existing Opportunity Zone business and expect to improve each individual asset which may be a chair or a computer or a desk and, frankly, doesn't achieve, you know, much of the economic benefit that we were looking to achieve in this program.

Much more important, I think, take an aggregate look at the value of its tangible assets and ensure that Opportunity Zone business is at least investing as much, just as you would in an analogous real estate example. And, of course, in the real estate context there is, I think, some practical applicability here as well. Practically speaking there are purchases all the time of a building and let's say an adjacent or adjoining parking lot of which the building is going to receive a tremendous amount of improvement, but the parking lot won't and there will be not economic case or business case to doubling the value of that parking lot, but you're still achieving the economic impact to that same area.

So I think there's real reasons to think through the aggregate improvement test. I think the ABA laid out a very good way to do it in its comments, which I won't go into in detail because they did, but I think that will be important to ensure there's investing in existing operating business in the Opportunity Zones, as well as practical investment in certain types of real estate projects.

The second issue I think that's important, I think will just need a minor clarification, is the treatment of the gross income test. So I think the IRS substantially won't use that term, I think the U.S. greatly improved its treatment of the gross income test between the October and April regs. One small note though, it used language that the gross income test applied to activity in the zone of the business which implies to some in the marketplace that they can't have Opportunity Zone businesses that stretch across multiple zones.

Of course, that would be the goal to have large growth businesses that can grow across multiple Opportunity Zones, and businesses that meet the — otherwise, the other criteria should be able to meet the gross income test across these assets, across multiple zones. I know my time is expiring. I'll just make one other quick comment and that is I think there's a question about whether Qualified Opportunity Zone businesses can hold subsidiaries in their normal course of business and not be excluded from investment because of the nonqualified financial property test.

The way that reads is it would prevent partnership interest in subsidiaries. Of course, this would be a normal way of doing business as a Qualified Opportunity Zone business or an investor in those businesses and there should be a rule in place. I think EIG and others have laid out a practical scenario of evaluating if you've wholly owned that subsidiary or invest at least 50 percent of it that it would not be treated against your nonqualified financial property test. Without allowing for subsidiaries to be invested in, I think you're going to limit the size and type of businesses that can be practically invested in throughout this program. Thank you.

MS HANLON-BOLTON: Thank you, Mr. Glickman. Any comments from the panel? Otherwise, I'll turn it over to Mike.

MR. GLICKMAN: I'd be offended if Mr. Novey did not ask me any questions.

MS. BOLTON: I know, right. You have a time limit.

MR. NOVEY: I assume you're suggesting that there's a workable nexus rule for aggregation in the (inaudible)?

MR. GLICKMAN: Yeah, of course there is. It relates to assets in tracts or adjoining tracts, contiguous tracts.

MR. CRNKOVICH: Mike, are you done?

MR. NOVEY: Yes.

MR. CRNKOVICH: Just one question. You talked about exotic structures and you mentioned 1245 recapture. What if you just elaborate on that? Are you thinking of a situation whereby if you sold the partnership interest the 1245 recapture would escape tax, where if it's a sale of assets, you know, down one or two tiers the 1245 would not escape tax? And then by virtue of that difference in rules, if I understand where you're going, there might be an exotic structure whereby you have a single asset fund such as the partnership interest could be sold in. Am I following you correctly?

MR. GLICKMAN: Yes. So it basically is just a difference of the language of 1250 and 1245 and how the regulations refer to the sale of single assets? So they talk to the capital gains that then the investors would not be on the hook for anymore. And in other parts of the statute they talk about a full step up in basis in the interest. Of course, capital gains works fine as a 1250 asset because it's considered capital gains. So you could add language that said you escape ordinary income or capital gains which I think Novagradac has recommended.

Right now a work around is to allow for interest at the feeder fund level to these individual QOFs that may hold individual, let's call it renewable energy assets and those — it could function in a similar way, but it's much more burdensome because then you have to collect investment for each individual asset and then transfer those interests back up to the feeder fund, and there's really no reason it should work differently from the real estate context. My sense is it's an inadvertent wording difference that could be corrected with an update in that wording.

MR. CRNKOVICH: Could a work around also operate to eliminate all ordinary income, income other than 1245 recapture such as sale of inventory?

MR. GLICKMAN: Yeah. Well, so I think in this case you just — the focus will be in the sale of the asset itself. So you're talking about selling what will most likely be an individual LLC containing the asset and a full — equivalent treatment to the full step up in basis of the value of that asset upon sale so that there is no outstanding tax event on a nonreal estate asset. So I think the goal is to get to that same result so that you don't have different results depending on the different types of assets that your Qualified Opportunity Zone fund may own in a multi-asset vehicle.

MR. CRNKOVICH: But just to be clear, if I start a widget making business in a Qualified Opportunity Zone are you suggesting that the income from the sale of the inventory if we sold it —

MR. GLICKMAN: Oh, no. No, no, no.

MR. CRNKOVICH: OK. You're focusing your comments on the real estate aspects, the 1250 un-recapture, 1250 gain, and the 1245 gain. I'm just trying to figure out where you would draw the line as what would be permissible to be eligible for the step up in basis.

MR. GLICKMAN: Yeah, I think it's, again, to treat them in the same way as a sale on the real estate components of those assets because it's the, you know, again, it's the core of this is the tangible property in the zone in the sale of those assets at the end of the 10-year holding period.

MR. CRNKOVICH: I'm just trying to understand whether the sale of a tangible could be extended to deal with a sale involved in a business that has a significant amount of other ordinary income assets such as an inventory. And you're not proposing that?

MR. GLICKMAN: I'm not.

MR. CRNKOVICH: OK. Thank you. Thank you.

MR. GLICKMAN: Sure.

MS HANLON-BOLTON: So I just want to confirm that your first comment is you believe that people are sitting on the sidelines because of our applicability rule where we didn't give the lines?

MR. GLICKMAN: Yes. I think that's why some investors are sitting in the sidelines in the multi-asset fund context which is, I think, will be the majority of the source of investment over time in this program because it creates the structure that's most scalable. And I've talked to many investors and many fund managers that are having trouble confirming to the investors that they can make sales, individual assets sales which is how most of these multi-asset funds are structured at the end of 10 years and provide them some kind of assurance that they're going to receive the tax treatment that they're expecting because of that language. And, in part, because that language is different than the language of the rest of the regulation — of the rest of the regulations that were released in April.

MR. NOVEY: And you're suggesting that what's necessary is reliance — that a structure which is created today would be able look back to the proposed regulations in 2046 and apply the terms of those regulations even if the final regulations are different.

MR. GLICKMAN: Well, correct. Just like —

MR. NOVEY: Again, I want to make sure that we're communicating effectively.

MR. GLICKMAN: Yeah, no correct. Just as you can anywhere else that's laid out in the April regulations. They may also have long-term consequences and the reality is there are now a not insubstantial amount of multi-asset funds in the marketplace that are having to essentially sell on their faith and a prayer that their analysis of where the regs are likely to end up, that these exits are going to avoid a tax event are, in fact, true. So, everyone in the market is taking on some amount of liability in interacting with their investors and others that this structure and the tax treatment that they're committing to their investors will be there. I'm confident that's where the IRS plans to go, but that's not enough for many investors to feel like they can deploy capital now into the marketplace.

MS HANLON-BOLTON: OK, anybody else? No. All right.

MR. NOVEY: Thank you.

MS HANLON-BOLTON: Thank you, Steve. All right, our next speaker, Dan Cullen and Darryl Steinhause from the Institute for Portfolio Alternatives.

MR. STEINHAUSE: Good morning. My name is Darryl Steinhause. I'm with DLA Piper. Dan Cullen and I are here representing the Institute for Portfolio Alternatives and I want to go over a couple of issues today that I think we could improve the regulations and provide some additional guidance.

The first is somewhat, what Steve talked about before, which is aligning exit strategies. When we look at these transactions today, there's three ways you can get out of these deals. The investors can sell their units; you can have the Qualified Opportunity Zone property sold, which are typically partnership interests; or, you can sell the underlying business/projects. In most of the deals done today, we have a fund on top; we have a partnership below; and the partnership below owns right now, typically a piece of real estate. And the problem is depending on where you are and how you're exiting your transaction, these don't give you the same result. So, I'm going to take the typical structure, which is the fund in a sub-partnership.

First, if you go to sell the property, you cannot sell the property and get the tax advantages. Second, if you want to sell the partnership interests, you can do that, but you have to exclude — you can only exclude the capital gain; and, third, if you sell the units as an investor, you get to exclude all of your gain. So, you have three different components of the same transaction exiting the same deal and you get different tax results.

So, what's the issues and problems with that? Well, first, in the real world, if you have to sell a partnership interest instead of selling the underlying project, you get a lower price. Buyers do not want to buy partnerships that have ongoing liabilities, uncertainties, reps and warranties, they want to buy the real estate. If you want to maximize the value to these investors, you have to let them sell the real estate.

Second, if you are trying to gather all the units held by the fund, it's difficult. You might have 100, 200, 300 investors and you have to gather those units and all sell them at one time. And if you're going to let your investors go to the marketplace, most of these deals are private transactions. How you go to the private marketplace without taking a significant haircut on you price? So, the only way to effectively make this work is selling the underlying project. The third thing is, multiple asset funds are at a complete disadvantage because they can't sell their projects. They can only sell their partnership interests, which will be at discounts, or they have to find one buyer to buy all of their deals at one time.

This is a relatively easy fix. You could just say, no matter which way you exited your transaction, there's no gain that would be triggered as you have with the underlying units of the funds today.

The second issue that I'd like to talk about is what happens when you have substantial improvements from projects for businesses? Currently, under the proposed rules, you have this being done on an asset-by-asset basis. That generally works OK for real estate. That, however, does not work for businesses or quasi-businesses. When we look at these transactions and you have a business or a quasi-business such as a hotel, sometimes you have new assets. You can't improve a new asset. Other times, you have assets that can't be improved. I mean, literally, how do you improve the towel at the hotel? What do you do? These things have to be done on an aggregate basis.

In addition, when you're looking at this from an aggregate basis, the most important thing is when these fields are done from a practical standpoint, the business or the project, they don't actually in business settings improve the property. And many times, they buy new property. When you're the hotel, you buy new towels; you buy new linens. That has to be allowed in this process, so it's got to be the purchase that allows you to improve — make the improvements, as opposed to specific improvements to the individual assets.

MR. CULLEN: Thank you Darryl. Hi, my name is Dan Cullen. I'm a partner at Baker McKenzie and like my friend, Darryl, I'm here on behalf of the IPA. Thank you for allowing me back. I had the privilege of presenting testimony on the first run of regulations.

I would like to specifically dive into two key points. The interest section of debt finance distributions. In your decision to incorporate a modified disguise saleable. Second, the interest section of inclusion events and tax-free transactions. I raised both of these issues on behalf of the IPA the last time around and I want to applaud you for the manner in which you've addressed them so far. I believe your proposed regulations, however, in one instance, took a step too far. I would ask for you to reconsider your approach.

And in the second instance, I believe the proposed regulations were drafted too narrowly. So, specifically, I'd like for clarification, or if I dare, modification with respect for debt finance distributions. When I read the regulations that came out, I was extremely pleased to see that you followed the inherent wisdom of Subchapter K and allow full outside basis for debt financing and no impact against accrued benefits to the extent there was distributions to the extent of that outside basis. I must say I was surprised, and in part, disappointed in the decision to incorporate a modified disguise saleable. When I hear testimony from others who are not tax counsel or accountants, and they are worried about traps for the uninformed, adopting a modified disguise sale rule in a manner in which you did, I believe creates a trap just like they're worried about.

Specifically, you modified the disguise sale rule so that it would apply, not just to the profit contributions, but to all cash contributions, effectively turning into a governor as to how the capital needs to stay within these funds. That step, I think, is prudent. Where I thought you may have made a mistake, is when you turned off one of the exceptions to that normal rule. Predominantly, the pro-rata distribution of debt financing proceeds. I would ask that you reinstate that exception and remove the trap from the unaware here. I believe that there is no hinderance to the policy we're looking to achieve. The members of the IPA are actively gathering and aggregating capital to be deployed in these neighborhoods.

In the furtherance of our objective here, if after a period of time they appropriate substitute their capital, for the capital of a bank and there's a pro-rata distribution, the policy has been achieved. We have allowed this for decades under Subchapter K in every other real estate or other transactions. I do not feel it is appropriate to narrowly limit that exception here for QRZ funds. I think it's contrary to the policy objectives trying to be achieved and I would ask that you consider (a), either not incorporating a reference to a modified to scale — disguise sale rule. I think you may have taken a step too far. Or if you choose to do so, and you leave that in, that you allow the exceptions to be modified as well.

In the alternative, if you will not reinstate the pro-rata debt financing distribution exception, then please provide further guidance as to when distributions would be accepted. The reason why I ask this is I think you're stuck with a bit draconian. If you violate the disguise sale rule here, you have a failure of your eligibility of your investment from the beginning and you've received none of the benefits. From a policy perspective, I think that was a bit harsh.

The second thing I asked the last time I was in front of you was that the intersection between inclusion events and tax-free transactions should be symbiotic. The reason why I asked for that was rather simple. I've been practicing for just shy of 20 years now, and over those two decades, we experienced some interesting problems for our clients between 2008 and 2012. I believe that the friction filled world that we live in will continue to be just that, and in spite of terrific policy and the best efforts of people trying to help these communities, some funds are going to struggle, and perhaps fail, and some funds are going to be successful. It is in furtherance of our policy objective to allow a more broad assistance amongst funds in those circumstances empowering counsel, such as myself, to allow some funds to affirmatively assist other funds that are struggling. It's going to be appropriate and it's something you should facilitate.

And I asked you to do that the last time I was in front of you. I believe you did so in part, but you only took a partial step. If you look at your list of inclusion events, you excluded a Section 721 contribution into a partnership. And I thank you for doing that. I do think that you will see certain UPI transactions, or UPC transactions that will allow combinations to take place when they're appropriate, and where the QOZ requirements are still being met. But I cannot contemplate why you only took that half step.

Continue walking forward. I think you should also include Section 351 transactions. I think you should also include tax reorganization transactions. It's in furtherance of the policy, and there shouldn't be a difference between whether or not a fund enters into an UPI transaction, or if they do a Tax B reorganization between two weeks. Please continue to include a more expansive list so that when one fund is struggling and it needs the help of another fund, they have all the options in the Code available to themselves. Thank you for your time. I appreciate your consideration of the IPA's requests.

MS HANLON-BOLTON: Thank you. And you have a comment letter for us?

MR. NOVEY: Yes, we have a comment letter that outlines 19 suggestions. I know you'll take all of them into consideration.

MS HANLON-BOLTON: Yes, every single one of them.

MR. CRNKOVICH: All right, Dan, Darryl, thank you. Dan, let me approach you first on the disguised share rule. It's not a disguised share rule, obviously. It is a rule that is designed to police extractions of cash shortly after the investment. So, the question I would ask you is how you would police the situation I'm going to lay out. Suppose Dan and Darryl, each put $100 into a QOF, a qualified opportunity fund taxed partnership. And let's assume varying effects. Don't even worry about. You each put $100 in. The next day, you go to the bank. You borrow $150 because the bank will loan, let's say 75 percent below the value and distributes it out 75 to each of you. The question is, should your investment — should your qualifying investment that permits a rollover gain for lack of a better term be the full 100, or should that distribution, which occurs say the next week, the next month, be taken into account to reduce the amount that's being invested?

MR. CULLEN: I'll answer that three-fold.

MR. CRNKOVICH: Great.

MR. CULLEN: First and foremost, as Mike noted earlier, both taxpayers and yourselves are wedded to the legislation. Section 1400Z-2 does not modify at all Subchapter K. So, the results you're describing would be permitted under Subchapter K and should technically be allowed. What you're concerned about, rightfully so, is from a policy perspective. Whether or not it's appropriate for private capital to get a tax benefit unless their money is sticky. You want it to stay in the neighborhood. You want them to be invested long-term. I think that's appropriate. However, the ability to put that capital in; do something with respect to that project in a manner that's going to allow third-party financing to give you that $150 in your example so that Darryl and I get to take $75 off the table is a step in furtherance of the policy. And to not allow me to substitute my capital with bank capital is an undue restriction on capital you're trying to aggregate. And I recommend that you don't apply that restriction.

MR. CRNKOVICH: So, just to follow that. If, in lieu of doing that, you each put in $25, and you borrowed $150, and invested the full $200 in a qualifying business, would you suggest that the appropriate policy call would be to permit a full rollover $100 gain for each of you? Because economically, those two transactions are virtually identical.

MR. CULLEN: They're virtually the same and the disparate treatment should not be allowed. I think that in each case, if we have done something for the property where a third party bank is comfortable taking on that risk and allowing us to take the capital off the table, then we've met the objectives of the policy and complied with both Section 1400-2, and Subchapter K.

MR. CRNKOVICH: So, just to be clear, you said there should be identical results with those two transactions. So, is that suggesting that if you each put in 25 and borrowed 150, and kept the cash in the partnership, that you two could each be treated as rolling over 100 in gain, as opposed to limiting your rollover amount to the actual cash you invested.

MR. CULLEN: I apologize. I misunderstood your original question. I think, unfortunately, the statute says that you have to invest cash into the QOF to get benefit from the troika of tax benefits allowed under Section 1400Z-2. Getting debt finance benefits is not cash that you have put in, it's the bank's cash.

MR. CRNKOVICH: So, the only question I'm asking is, if you could enter into an economically, virtually identical transaction and get a much bigger result, is that something the government should be concerned with and write a rule to prevent? Or should the rules be drafted where you each put in $100 and you borrow $150 in a prearranged plan, say the very next day and extract the $75 each?

MR. CULLEN: You are correct that in a perfect world without friction that that result could occur. And I think inherent in your example and your question is, why would one be concerned about being able to have the partnership borrow the money and distribute out the funds when one could put in less — put in more and then just leverage your outside position from a bank directly? The world in which we live in doesn't have that inherent flexibility in all circumstances. The bank may not be as willing to lend to somebody individually as they would to the partnership that has the collateral and the assets. So, I would respectfully propose that your two analogies when actually occurring in the real world are not analogous.

MR. CRNKOVICH: And if putting aside the outside borrow, and putting aside plantation patterns and issues, again, you would be comfortable — or you think we should write a rule that would permit the partnership, that client base case to borrow shortly after the infusion of cash — extract the cash, have the partners take it as a distribution, and yet not count that distribution as reducing or against the investment. That's the rule you would prefer.

MR. CULLEN: Correct.

MR. CRNKOVICH: OK, I just wanted to understand that. And then, I have a question for Darryl, just on your buyer and seller piece, again, I appreciate all your comments, so, we know that if an investor sells its interests, then — under the 2C 10-Year Rule, there's that 743 type rule that would eliminate all the ordinary and capital gain. Right?

MR. CULLEN: Mm-hmm.

MR. CRNKOVICH: If you, in lieu of the having to sell the partnership for sole property, would your rule limit the benefit under 2C to just capital gain? Under capture 1250 gain? Would it include 1245 recapture, and would it include any other ordinary invites?

MR. CULLEN: I think that there shouldn't be a difference how you exit. I think that if you sell any of the three, when you get done, you have money in your pocket and you don't have an investment. And to tell the investor that you get different tax treatment if we sell the underlying project, the underlying partnership interest, or that your unit seems a little unjust.

MR. CRNKOVICH: Would your approach require that in the event of a sale by the partnership to create equilibrium or parallel structures that — would your rule require that the QOF, and ignore lower tier partnerships, would the QOF take the distribution or take the proceeds of the sale and distribute it out to the investor so that you're in an identical position?

MR. CULLEN: I would think that would be a fair rule because you're trying to put everybody into the same economic position.

MR. CRNKOVICH: OK. So, if they didn't distribute it under your rule, they would not be eligible to avoid any of the gain? Would it be limited to the capital gain under Chapter 1250?

MR. CULLEN: If they don't distribute it, maybe then you put them back in the penalty box of just the capital gain. But if they distribute the money, everybody is on equal footing and equal treatment.

MR. CRNKOVICH: Fair enough. Thank you.

MR. NOVEY: Just a confirmation of what you said. You were saying why is it that you can't — there would be an addition, or a problem with having to improve properties such as towels, I think — I just want to make — I understood you as having said that the acquisition of new qualified opportunities on business property, which is what those towels should qualify as a form of substantial improvement, or some other asset in need of substantial improvement with which there is an asset acquisition. Is that what you were saying, or am I misunderstanding?

MR. CULLEN: What I'm saying is if you have towels, you're going to throw them out and you're going to buy new ones.

MR. CRNKOVICH: New ones, I would think would be qualified opportunities on business property. Since they're new they don't need — since they're new to the zone they don't need any substantial improvement. So, what is the problem you're trying to address?

MR. CULLEN: You still have to improve. You have your old property that you have to improve. So, you have to still make the test. So, I believe you're looking at the distinction between original use and substantial improvement. When you come in and you buy an operating business, the FF&E, furniture, fixtures, and equipment, that's your first purchase. A new purchase would qualify. And so you're focused on the next towel. I think we're focusing on partnering clarification that the first towel existing when you purchase doesn't need to be improved.

MR. CRNKOVICH: Since you throw it out, in what way is that going to impair you at the end of the quarter? Or at the end of periodic test.

MR. CULLEN: So, there is likely going to be a period of time between your initial purchase and the date in which you throw out that first towel. And I like that we're focusing on a single example of towels, but it is a much larger example. If you look at operating businesses and your purchase price allocation to FF&E, we're talking about a significant dollar amount. And so the delta of time between your initial purchase and when you ultimately would throw it out and make a qualifying purchase, we're just looking for clarification of what otherwise, I think is obvious, is that one cannot and shouldn't be required to substantially improve those FF&Es for the first initial purchase.

MR. CRNKOVICH: As long as you throw them out and replace them.

MR. CULLEN: If I want to keep the towel forever, I think my customers would be unsatisfied, but I don't think you need to force me to throw out the towel. I think you simply need to clarify that I don't need to improve the towel. That that initial purchase, — although the overall transaction is a transaction that falls within the bucket of substantial improvement that some sub assets cannot be and should not be required to be substantially improved.

MR. CRNKOVICH: OK, so you're saying then that they are never going to qualifying opportunities for the property and you want to keep them out of the denominator as well, or you want to put it in the numerator because they can't be improved?

MR. CULLEN: It's a fair question. I'm not sure what the best approach would be to exclude them and still make it appropriate to apply the 90 percent test. We'd be happy to collaborate with you to figure out how one would exclude them out and still meet the objectives of the 90 percent test.

One idea, although I think it would be hard to police and I think you would have to have self-enforcement, would be to allow a bifurcated approach as a (inaudible) part. Treat them as original purchases even though they've been used before, and the remainder would be substantial improvement. When you look at how people have been saying that you should be able to buy used assets that are brought into the zone here for some of that FF&E, allowing it to be treated as original use where it is physically impossible within the world as I know it to really improve certain towels, or when you look at how people have been saying that you should be able to buy used assets that are brought into the zone here for some of that FF&E, allowing it to be treated as original use where it is physically impossible within the world as I know it to really improve certain towels or pillows or mattresses or whatever else that you're going to have, I think excluding (inaudible) the approach.

MR. CRNKOVICH: The stuff that's brought in from outside is original use.

MR. CULLEN: Correct.

MR. CRNKOVICH: Even if (inaudible).

MR. CULLEN: Correct. And so what I'm asking from a practical purpose is don't force the taxpayers to bring in something from the outside to allow them to buy the towels and (inaudible) there.

MS HANLON-BOLTON: So I guess I'm a little confused because when we talk about activation, and it's had this question before, you know, I'm thinking you buy a hotel and you have furniture and towels and all of that. So it's all in the purchase price. So let's say you buy $100 and that includes the real estate, I thought you wanted to just double the 100, but not have to put it into those — the towels and stuff.

MR. CULLEN: Yes.

MS. BOLTON: You want to be able to put it into the total building.

MR. CULLEN: Total cost. You buy the building, you buy the towels, you buy everything, $100, you got spend another $100. That's what we're looking for.

MS HANLON-BOLTON: OK. All right. Any follow-up questions? OK.

So thank you very much. We appreciate your comments.

So right now it is about noon and we're going to take a very needed break. So as I said to you before, we have a lunch room that is up the escalator to the left. And we have escorts outside in the lobby that will show you where to go. Let's be back here at about 12:45 and we can start with Brent Carney at 12:45. Thank you.

(Recess)

MS HANLON-BOLTON: OK. Welcome back. I hope you all had a nice lunch. Well, we took a little bit longer than we expected. But, all right. So we're just going to start up again, and we've had a little change to the schedule because one of our speakers has a flight to catch.

So, the next speaker will be Argyrios Saccopoulos. Did I get it right?

MR. SACCOPOULOS: Anybody else has got comparable problems with (inaudible).

MS HANLON-BOLTON: Yeah. Let us know if you have comparable problems. I don't know how much they can change that. But Argy is from the State Bar of Texas, Tax Section.

So, one thing for speakers, if you could make sure that you are speaking into the mic, because sometimes when you're talking to the Panel, the people in the back are not hearing. So, we are requesting people to come down further, if possible.

MR. SACCOPOULOS: Hi. Thank you very much for the opportunity to testify. My name is Argyrios Saccopoulos. I represent the State Bar of Texas, and I'm also in private practice at Jackson Walker where I do fund formations. And a lot of my clients are trying to set up qualified opportunity funds, and then advising them there are a few ambiguities, and frankly potential issues that I was hoping to bring to the Panel's attention, respectfully.

And I guess before I get into the two main topics I want to discuss, I just want to briefly touch on the inside gain issues that a couple other panelists addressed. That's something that we've been wrestling with as well. I've actually been advising clients to set up parallel cross structures, where there's still ambiguity in the rules regarding how inside gain will be treated, especially where there could be 1245 recapture.

Even for real estate investments, if you have, you know, cost seg and some of the purchase prices allocated to depreciable assets, you would return to the same issue even with the real property investment.

So, I would respectfully suggest that given that the statute operates by excluding all the gain from the investment held for 10 years by increasing the basis to fair market value, 1245 recaptures an element of that fair market value.

And so in all I think the final reg should address that. And in the context of operating businesses I respectfully suggest that if the assets of the trade or business in the Section 1060 (inaudible) sold, it would be appropriate to have a full exclusion for that, for the decision of that investment.

The two main topics I wanted to discuss, one of which was touched on a little earlier by, I think it was Mr. Glickman, regarding carried interest. I have a slightly different take on that, [that] the position of the State Bar, and my personal position is I think it's completely appropriate for carried interest not to qualify for the fair market value basis election and for a tax-free exclusion after 10 years, because that amount does not represent an investment of capital gain.

However, I think there is an issue in the proposed regs regarding how a partner's units or a capital account is apportioned as between a section that might represent a valid capital gain rollover versus a section — a portion of the capital account that represents the carried interest.

And the example that I bring to your attention which is exceptional economy in the market, I think — I would say most of the deals, or qualified opportunity fund offerings I work on have some kind of economic deal that's similar to this.

You have a waterfall with multiple tiers, and in tier one of the waterfall — well, let me just back up. Suppose the facts are that a sponsor co-invests with outside investors, the sponsor puts up — let me just look at my example — 10 percent of the capital, and the investors put up 90 percent, and the deal is that everyone gets an 8 percent return on their money, and only above that 8 percent IRR does the sponsor earn an incentive allocation, or carried interest.

And the way that works is the sponsor always gets his percent of the profits, and the investors get their 90 percent of the profits up to a 28 percent IRR, and then any profits above that go 80/20 in a typical deal.

But the problem that we're encountering is that you have two, at least two basic ways that a fund might be set up. You might have a general partner that makes that capital gain investment which might be a perfectly good capital gain rollover just for the LPs, and then that general partner also gets and inventive allocation.

Or you might have a separate management company that gets the incentive allocation which make perfectly good sense for sound business reasons, because you're giving some incentive allocations to different parties that rolled-over capital gain, or there's Texas margin tax reasons. Being a Texas lawyer, that's probably all esoteric.

But the point is that these two structures don't seem to be treated the same. In particular there is this concept of an allocation percentage in the regs, which you've defined as the highest share of residual profits, the next fund's partner receive with respect to the carry.

And I'm not sure if this is intended, but at least the way we're all interpreting this as practitioners, is that's a fixed number and it's like the worst number for the carried interest person. And in the example I gave just now, and the facts I laid, I believe — and correct me if my math is wrong — that that number is 64 percent.

Because above the 8 percent hurdle, that's where the highest — that's the only tier in the waterfall on which that carry is earned, and in that tier, you know, for every hundred dollars that's earned, 10 bucks goes to the sponsor for his capital interest, and 18 bucks goes to the sponsor as 20 percent of the other 90.

And so out of the 28, 18 out of the 28, or 64 percent, is carried interest. And because the regs don't distinguish between profits that are earned above and below the hurdle, this appears, the way a lot of us are reading it, to effectively convert part of the sponsor's 8 percent return on its capital, the same as the money partners are getting, into a deemed carry that effectively causes the carry — I apologize for the metaphor — to almost be like a cancer in your capital account.

It causes — it metastasizes and takes over parts of the capital account it really shouldn't, and as a result if a single capital account represents both capital and carry, that's a bad structure, and that's a bad way for a sponsor to invest.

And so we've been advising clients to go the route of having a separate carry vehicle with a separate capital account, which makes the rule in the regs effectively elective, and a trap for the unwary.

So, I'd guess we'd respectfully suggest that there's a number of ways this could be addressed. First, you could define the allocation — instead of using the allocation percentage concept, you could say that the allocations and distributions with respect to the carry are defined in the negative as the allocations and distributions that are not in respect of the capital.

Alternatively, if you don't want to provide guidance that people could rely on, and people who are cleverer than me could think of ways to abuse that, you could say something like: the allocation percentage rule is a safe harbor, and inappropriate circumstances, you know, and other methodologies including inappropriate circumstances, the kind of negative by exclusion rule that I just described, could be a way to handle that.

The second point I wanted to address was the 90 percent holding period rule, where substantially all of the holding period is defined as 90 percent. We don't have any issues with that as a concept, but we have questions about how that's administered.

And the example I've given in the prepared bullets was, suppose that a qualified opportunity fund invests 100 percent of its assets in a QOCB, that's intended to be a QOCB, and for whatever reason, you know, pick among the many, the menu of options for a QOCB could mess up, they mess it up, and for six months not QOCB.

But then they come into compliance and at all times thereafter they're a QOCB. Well, I mean the observation is that 10 percent, that that six-month period of noncompliance represents less than 10 percent of a holding period of greater than five years, and so once you hold the QOCB interest for five years, retroactively you can determine that you have been in compliance for the entire period, and yet you have to report your ASSET Test results every year.

So, what do you do in year three, when your holding period is three years, and that six-month period is more than 10 percent, but then later retroactively becomes less than 10 percent?

What we've suggested is that you want to be able to — given that a (inaudible) vehicle for long-term investment, the statute includes the concept of a 10-year holding period where all the dues comes in, you should be able to take your business plan into account, and your future holding period, if you're going to assess a 10 percent standard.

Because otherwise you'd have to seemingly report a failed ASSET Test, [and] pay a penalty tax. And then what do you do in year five, when it turns out, well, now that I've held it for long enough, it turns out that I was in compliance all along, and I shouldn't have been paying that penalty tax?

So, you could limit the assumed future period of the lesser of 10 years or remaining useful life, and I think that would be appropriate.

Alternatively, I want to, I guess draw the Panel's attention to the fact that the statute permits a Qualified Opportunity Zone business, or a partnership interest to be a good asset for a QOF, if it is a QOCB or if has interest in a startup, or what I think it says, a new entity formed for the purposes of being a QOCB.

And in that case I think there should be a defined kind of grace period for a startup, because the statute says, you know, there's two ways that a partnership interest can be good, it can be a QOCB or it can be new, and formed for the purposes of eventually being a QOCB.

So I would, you know, respectfully suggest that the grace period ought to be a year, because in the context of the 10-year hold period that the statute contemplates, that would align broadly with the 10 percent standard.

The last couple of points that I want to address very quickly, is we were hoping for additional clarification on the definition of a triple net lease, there's other context in which merely passing through certain costs to the tenant, you know, for taxes and insurance, and everything, could cause the lease to be deemed to be triple net.

But we think that if the services in respect of those expenses are being reformed then the cost should be able to be passed through to the tenants without causing an issue there, because we're really trying to define an active standard, and understanding that the statute requires an active trader business, triple net lease isn't enough but, you know, we don't think that simply negotiating cost-sharing should cause an otherwise good lease to be — to cause you to fail the active trade or business test.

Am I out of time? I'd like —

SPEAKER: Yes.

MR. SACCOPOULOS: OK. Sorry. Thank you. Thank you very much.

MS HANLON-BOLTON: All right. Thank you. Do we have any question from the Panel?

MR. CRNKOVICH: Thanks for your testimony. That was very helpful. You talked about the separate carry vehicle, and there are a couple of interesting (inaudible). Do you have those in your written testimony?

MR. SACCOPOULOS: Yes. The written testimony —

MR. CRNKOVICH: If we could go through those too and I mean —

MR. SACCOPOULOS: Well, we submitted two documents one of which was the longer testimony and the other was the bullet points for this speech.

MR. CRNKOVICH: Great. OK. So you can do that?

MR. SACCOPOULOS: Yeah.

MR. CRNKOVICH: And just if I can just spend 30 seconds or a minute and go through two C issues you raised, and kind of the key, or carrying on of what I asked about two prior people who are testifying. So, if you own interest in a partnership and you sell your interest after 10 years, and assume that the look through applies to a revised step up equivalent for all the assets in the game, so you're aggregating, your point would be: the similar rule ought to apply if the partnership were lowered to your (inaudible) assets. Correct?

MR. SACCOPOULOS: Yes. Assuming that that was the disposition of an investment, because I think that the statutory word is investment.

MR. CRNKOVICH: Right. And I guess, I just want to drill down on that. How would you define investment? So, again you have been — you rolled over $100 into a QOF, and then putting aside the 1226 gain recognition, 1231-26, the investment increases in value from $100 to $1,000 if you sold your interest you pay in tax.

MR. SACCOPOULOS: Right?

MR. CRNKOVICH: Now, assume that the partnership sold off some of or all of its assets, assuming it's just some, how would you envision your work in the new approach?

MR. SACCOPOULOS: I think it has to determine whether what the partnership sold was an investment, and so you raised the example of inventory earlier.

MR. CRNKOVICH: Yes.

MR. SACCOPOULOS: I think it's obviously inappropriate, because inventory is not an investment, but I think that if it's like a real estate asset, or if it's a tangible asset that simply, where there is capital gain, but there also happens to be 1245 recapture. Or, if it's a collection of assets that represent a trade or business, and I think Section 1060 does a good job of defining that, if goodwill attaches.

MR. CRNKOVICH: OK. And so if you did sell the whole business, in your view, would there be a requirement to distribute the proceeds out to put the investor — and I can't pronounce your name, I'm sorry.

MR. SACCOPOULOS: Argy, that's OK (crosstalk).

MR. CRNKOVICH: Argy. In the same position as if you had sold your interest, would you have a distribution requirement?

MR. SACCOPOULOS: I think it would be reasonable to have a distribution requirement in that case.

MR. CRNKOVICH: And would the benefit encompass — only recapture 1258 and 1245 recapture in the actual gain as well?

MR. SACCOPOULOS: Actual gain, if that gain is in respect of an asset, that's part of the trade or business under 1066.

MR. CRNKOVICH: Got it. OK. That's helpful. Thank you.

MR. SACCOPOULOS: Thank you.

MS HANLON-BOLTON: So, I just want to clarify, for the 90 percent over the period, are you suggesting it's a retroactive rule, so you determine at 10 years that you've hit the 90 percent.

MR. SACCOPOULOS: Well, what I'm suggesting is that we need a rule that will let us report a good ASSET Test if the bad holding period represents more 10 percent of the holding elapsed to date, but less than 10 percent of the holding period that you assess will be the final holding period when you dispose of the investment, understanding that that's a hard rule to implement.

But the fact is the holding period increases at the rate of one year per year, and that means 10 percent of your holding period increases at the rate of, you know, 37 days per year.

And so, if your holding period is constantly going up, eventually it might encompass a bad holding period that was bad initially, and that's a problem that should be addressed, and we've suggested a couple ways of doing it.

MR. NOVEY: How does that work in the statute of limitations?

MR. SACCOPOULOS: That's a very good question. And that's in fact one of the problems there, because if you report a bad ASSET testing in the first year, and then in year six or seven you retroactively determine, well, at this point we can substantiate, we were always good, even back in year one we were good.

There's no mechanism to get a refund, and so it just seems like it's setting up a trap for the taxpayer where they have to report that ASSET Test even though their business plan involves only — have been compliant with the 10 percent.

MR. NOVEY: Then what happens if they plan on being good after year nine, but they aren't?

MR. SACCOPOULOS: Well, in that case I think they would have to report a failed ASSET Test for that year, and I mean it depends how harsh you want to be, I think that if you meant to be good and something happened beyond your control, or that was unforeseen, and it caused your prior ASSET Test reporting that you said was good to be in fact wrong, then there should be a consequence to that. And I frankly don't know how far you could go, but certainly you could have a bad ASSET Test, at least for the year that you have the changed circumstance.

MR. NOVEY: You seem to be suggesting reasonable cause and —

MR. SACCOPOULOS: Thank you for the prompt. Yes, I am.

MR. NOVEY: But if there isn't reasonable cause, shouldn't the IRS try to come back and say, you know, none of the original investment was OK, the entire and usually one of potential (inaudible)?

MR. SACCOPOULOS: I think that if you're — I think that a taxpayer in that situation is in a perilous position because if they have a failed ASSET Test I don't think there's any mechanism for saying you never had a good QOF, and so there are limited remedies for the IRS in that case, and that is one reason why I suggested the alternative of a one-year grace period for a startup QOCB, which would address about 90 percent of the issue.

Understanding that it doesn't address the issue of tangible property used in the zone in some of the other — but if you had a one-year grace period at the start that would address the cases of early noncompliance in a QOCB, while maintaining the spirit of the 10 percent rule.

MS HANLON-BOLTON: Anybody else? All right. Thank you very much.

MR. SACCOPOULOS: Thank you.

MS HANLON-BOLTON: Our next speaker is Brent Carney from Maraziti Falcon, LLP.

MR. CARNEY: Good afternoon. My name is Brent Carney. I'm with the firm Maraziti Falcon. We are a small law firm in the state of New Jersey, where we mainly represent public bodies, and we serve as a Special Redevelopment Council for several public bodies in New Jersey, many of which have Qualified Opportunity Zone designations.

And my public comment this afternoon is going to focus on Qualified Opportunity Zone business property. And the statute there, among its requirements, focuses on the acquisition of property in a Qualified Opportunity Zone where the original use, that's what I really want to focus on, is the new proposed definition originally used.

The original use of such property in the Qualified Opportunity Zone commences with the qualified opportunity fund, and then this is important word "or", or the qualified opportunity fund substantially improves the property. And the statute has a very clear definition of substantial improvement, and it has a timeframe, and in the redevelopment world a timeframe of 30 months, at least in my world, is a very tight timeframe.

So, for our practice and for our municipalities we're focused on original use because the statute does not associate a time period with it. And so in the second round of the draft regulations, for the first time, the IRS has put in a proposed definition of "original use" and I am just going to jump around in that definition. The definition includes "used tangible property satisfies the original use requirement if the property has not been previously so used or placed in service in a Qualified Opportunity Zone." That makes perfect sense. That would be a new use that is acquired by the Qualified Opportunity Fund. It's commencing with the fund, the 30 month time period would not apply in that situation.

It follows if the tangible property had been so used or placed in service in the Qualified Opportunity Zone before it acquired by purchase (sic) it must be substantially improved, and it's using the same definition of substantial improvement, that also makes perfect sense because that's not really something that commences with the fund. For example, if it was an apartment building that was acquired by the Qualified Opportunity Fund, it's just going to continue the existing use that clearly is not an original use that's commencing with the fund and so it would then follow under the "or substantial."

But we also have vacant properties and I was here for the hearing on Valentine's Day and I know that there was a lot of comment there about what period of time would abandoned or vacant property be considered to basically wipe out or delete the prior use so it could — if it commenced again, it would be considered original use and at that hearing, there were a lot of comments proposing basically one year, a one year period of time for abandonment and vacancy — that should wipe out the prior use and it could count as original use. In the federal register, the IRS and the Department of Treasury commented back. They disagreed with the one year proposal given the different operation of the Opportunity Zone to intentionally cease occupancy property for 12 months in order to increase its marketability to potential purchasers after 2017. Other commentators proposed longer vacancy thresholds ranging to five years.

In other words, I think the concern was that property owners would intentionally vacate their properties to get the benefit of either property acquisition by a qualified opportunity fund and so 12 months didn't make much sense. Our proposal is rather than going to the extreme of five years which was sort of the upper end I think of the public comment, that perhaps you can retch that debt back down to two years because there are a lot of properties, at least in some of the towns I represent that do have vacancies of properties that are less than five years that would certainly benefit under the Qualified Opportunity Fund program if that prior use was deleted or considered vacated after a vacancy of at least two years so that is our suggestion and wish and desire before the final regulations are proposed so that's really — I had other comments but that's really what I wanted to focus on.

MS HANLON-BOLTON: Comments?

MR. NOVEY: One question about the commenting in paper. You suggested that five and seven year basis —

MR. CARNEY: Oh.

MR. NOVEY: Should be available at least until the expiration of status as a Qualified Opportunity Zone and in any event, the basis is measured not by the current — I'm sorry, the stack up is measured not by the current basis but by the amount of (inaudible) so you seem to say if we can get the 10-year benefits until —

MR. CARNEY: Mm-hmm.

MR. NOVEY: Until 137, even if we don't get (inaudible) do this. I think that there were two suggestions that you made, one of which may have more probable with the statute than the other.

MR. CARNEY: OK.

MR. NOVEY: The idea that one could start the seven year period and the five year period after 12/31/2026 would have a problem because you get the benefit of that step up only if the investment is associated with a deferral election and a deferral election could be made —

MR. CARNEY: So if —

MR. NOVEY: The other one, where you are saying if I had a good deferral election earlier, maybe I should be able to continue to get my (inaudible) 10 percent — subsequently, the 12/31/2026, as long as I started out OK, that one might have less trouble with the statute.

MR. CARNEY: So, actually, I wasn't necessarily tying the step up and the basis for the ten percent and the 15 percent cumulative based on getting the deferral or not. All I was pointing out there was that also in the statute, in terms of the deferral, the 10-year deferral, that is actually statutorily defined to be December 31, 2026, that we pay April 15, 2027, whatever that tax rate is at that point and time but unlike the sections that deal with the ten percent and then the extra five percent in the step up of basis, Congress did not put into the statute a time period and because the proposed regulations were allowing up to the year 2047 for the qualified opportunity fund to actually sell the property and I assume that was done partly so that it wouldn't be a fire sale if it was a bad market after you have been holding it for ten or more years, so two, it would not be beyond your ability, because you would not be — you're not constrained by the statute, it could be in your regulations to also allow that sort of flexibility with the step up and gain of ten percent and five percent because everywhere I go at least, when I listen to panels on the — I am going to talk about the seven-year step up, in order to hit that, it's always talked about, well that would mean that the investment has to be done before December 31 of this year.

MR. NOVEY: By?

MR. CARNEY: By December 31 of this year and all I am suggesting is in your regulations, if you were to allow the same flexibility that you are for the sale of the qualified opportunity fund to sell the property all the way to the year 2047, if you allow that same flexibility, then it would actually enhance, I think, the ability of qualified opportunity funds to go into Qualified Opportunity Zones because they are not losing that seven percent — not seven percent — they are not losing that 15 percent step up in basis over a period of seven years.

MR. NOVEY: I understand that point that you are making. You seem to be making an additional point which was you would be able to get the five percent and seven percent even —

MR. CARNEY: Five and 10.

MR. NOVEY: Even investments into a QOF subsequent to I guess the latest possible date would be — the sale, you could defer something that was sold in December 31, 2026, then you could make your investment as late as June of 2027 but beyond then —

MR. CARNEY: Right.

MR. NOVEY: You would not have a valid deferral election and therefore, the five percent and 10 percent step ups would be unavailable for investments that —

MR. CARNEY: Well, correct, and also the zones themselves will automatically expire.

MR. NOVEY: So that we —

MR. CARNEY: Yeah.

MR. NOVEY: We indicated that maybe even the — since we didn't want to have a situation where virtually all — we didn't want to have a situation where virtually all of the 10-year basis benefits would be gone once the zones expired —

MR. CARNEY: Right.

MR. NOVEY: And we also didn't want to have a situation where we preserved the step up but once the zones expired, it was — there was no continued requirements of complying with the economic focus in the zone. We soft-peddled the consequences of that exploration.

MR. CARNEY: Yeah, and I think that's a good thing. Thank you.

MR. NOVEY: All right, thank you very much.

MR. CARNEY: Thanks.

MS HANLON-BOLTON: All right, our next speaker is Jill Homan from Javelin 19 Investments LLC.

MS. HOMAN: Good afternoon. Good afternoon, everybody. This lunch again. My name is Jill Holman and I am president of Javelin 19 Investments, a Washington, D.C.-based development and advisory firm. I have 15 years experience in real estate acquisitions and development and to date, my firm has been involved with almost 200 million in qualified opportunities to investments. I also serve on the Board of Directors of the Opportunity Zone Focus Trade Association and the Opportunity Zone Association of America and since I last spoke to you on

Valentine's day, we have capitalized our Opportunity Zone student housing project in Baltimore, Maryland, and are poised to start construction.

The project features what the OZ legislation envisioned in fulfilling a need, housing for students in ways that positively impact the community.

Well, you have my working group submission. In the interest of time, I will focus my remarks briefly on five quick subjects most likely to unlock still hesitant investors. I appreciate the chance to speak with you.

The first topic is qualification of already owned property. So many properties owned by taxpayers as of December 31, 2017, are the subject of planned development extending into 2018 and beyond. Still unclear is whether a sale of that property is needed in order for work done with respect to such property to qualify as Qualified Opportunity Zone business property.

Said differently, if a taxpayer has owned land or land in building prior to January 1, 2018, can improvements to that land or land and building, in 2018 or later, qualify as QOZBP?

The question is whether improvements funded by a QOF investment contribute a separate item of qualified property in situations where expenditures exceed 70 percent of the sum of the investor's basis in the already owned property and otherwise qualifying costs.

The regulations could treat the preexisting property as one asset owned by the QOF and its subsidiary entity in the improvements as another and analyze the "substantially all" test with respect to these two assets. I can offer mathematically confirming samples but I think you understand the points.

Other tax credit (inaudible) specifically provide for these special asset treatments and I wholeheartedly support this interpretation. The second topic is aggregating expenditures to satisfy the substantial improvement test.

Under the proposed regulations, the substantial improvement test for used property is calculated on an asset by asset basis. Issuing the aggregation of related assets methodology.

The statutory language which calls for expenditures with respect to the used property seems to more logically support an aggregating of eligible expenditures. Consider a single owner who owns multiple residential buildings in land on the same parcel in the same Opportunity Zone and who has a comprehensive community focus development plan to rehabilitate the buildings while adding a new playground for the younger residents in a new commercial area to satisfy the retail needs. These additions are clearly, with respect to the existing buildings, but the current regulations would require that the rehabilitation meet these substantial improvement requirement on an individual basis.

I recommend that the IRS adopt a regulation permitting the substantial improvement test to be passed for — with three things: One, if a written development plan which meets the substantial improvement test on an aggregate basis including both the rehabilitation of the use buildings and the cost of new construction; two, expenditures are made on contiguous properties; and three, the written plan is approved by a local governmental body responsible for authorizing development activities.

The third topic is alternative methods of gain exclusion and we have touched on this a bit before with the other speakers.

Currently, dramatically different tax treatments result from the sale of a QOF, a QOZB, and a QOZBP. In fact, the selling of QOZBP appears to not yield any Opportunity Zone tax benefits.

I strongly urge the IRS to synthesize these three scenarios and explicitly allow for the sale of QOZBPs to produce the desired OZ tax benefits to its QOF investors. Right now, an OZ investor may achieve gain exclusion after 10 years only by selling its QOF interest.

Gain exclusion is achieved by an investor election to increase a tax basis of the QOF. QOF interest to its fair market value immediately before the sale or exchange.

If the QOF is a partnership, the proposed regulations also provide that the QOF increase its basis in the partnership by the same amount. This can benefit a QOF partnership that owns assets that otherwise would generate ordinary income upon disposition but a different result occurs if the QOF sells its interest in the QOCB.

In that instance, the proposed regulations provide that if a QOF partnership or S Corporation recognizes gain upon the disposition of its QOZB investment, an investor that has held its interest in the QOF for at least 10 years, may elect to exclude from income some or all of its share of such gain attributed to the qualifying investment.

The election only permits the QOF investor to exclude from income capital gain from the result of the — from the sale of the qualified property.

It does not specifically or explicitly apply to innate ordinary income resulting from the qualifying sale such as depreciation recapture.

I appreciate that there is language in the proposed regulations to suggest that the 10-year asset sale applies to sale of property by a QOZB but I do not believe that it explicitly states so.

Most QOFs are being structured with subsidiary entities owning the underlying property. For business reasons, not tax reasons, most buyers prefer to purchase property assets rather than interest in entities which own the property.

With these observations in mind, I recommend that the IRS extend the exclusion provision to the entirety of the sales of property held by the QOFs, not just capital gain, as well as the sale of QOZBP held by subsidiary entities in which the QOF invests to the extent such gain is allocated to the QOF.

And finally, the tenure asset sale election is not one on which the investors may rely. This chills many potential investors who make investment decisions based on certainty of tax results.

Looking at dispositions 10 years or more into the future, investors are extremely reluctant to commit dollars today without having a sense of what the rules will be applied when they may dispose of the investment.

Investors are being told the no tax after 10 years rule may apply and may be available depending on what the IRS ultimately decides with no particular commitment to publisher rule before their investment is made.

The proposed regulations should be one on which the investor may rely. And fourth, triple net lease and active conduct of a trade or business. The proposed regulations confirm that the business of leasing real estate can qualify as an active trade or business for opportunities and purposes.

Treasury then muddies the waters a bit by saying however, merely entering into a triple net lease is not enough to be the active conduct of a trade or business. Opportunity zone investments are naturally aligned with the preservation and rehabilitation of communities historically significant buildings and many rehabilitations supported by historic tax credits utilize a master lease structure for credit delivery.

With the industry — with we in the industry are struggling as I think you've heard, in the uncertainty of the word "mere" as Treasury use didn't ask for guidance through the use of examples in clarifying language. For example, you could use section 199(a) in the context of the qualified business income deduction and to keep it short, I won't keep that and the fifth topic is QOF investor relief if proposed financing or other conditions fail.

There are many instances where an investor is admitted into a QOF but the proceeds are not deployed into the project until certain conditions precedent are met so the sponsor is comfortable or financially able to move forward with the — on the OZ project.

Satisfying these conditions may be subject to actions of third parties, force majeure, or the inability or ability of the developer to raise capital equity or receive the financing in which case the sponsor of the QOF may choose to simply return the investor's money if they are not able to meet those conditions.

Similar to reinvestment following dispositions, Treasury should allow taxpayers who have returned their gain investment dollars through no fault of their own, 180 day window to reinvest into another QOF.

Lastly, I know others are going to speak on the concern with the netting rule applicable to 1231, gains and losses. We provided commentary on that as well and add my voice to reconsideration of that rule and this concludes my remarks and I appreciate the opportunity to share with you today and on what I think will encourage more investments in the zones. Thank you.

MS HANLON-BOLTON: Thank you, Jill.

MR. CRNKOVICH: Jill, thank you for your helpful points. Just the -2C 10 year rule, would you envision a rule, as I asked the others, that would require a distribution of the proceeds in order to — for the QOF to avail itself of the 10 year elimination?

In other words, if there is a sale outside —

MS. HOMAN: Mm-hmm.

MR. CRNKOVICH: That's one thing the investor has the cash and the buyer of that can never get the benefit.

MS. HOMAN: Mm-hmm.

MR. CRNKOVICH: So the question is should you have something between that and the situation where the sale is inside, such that there would be a requirement to distribute the proceeds.

MS. HOMAN: I think that is fair. And ultimately, from a business perspective, I — most investors I have spoken with who are investing, or considering investing significant amounts of capital, do not understand that there are different treatments at the different tiers and I think whatever gets us to the parity and synthesizing those three outcomes, I am fine with.

If that means the distribution, I would be fine with that.

MR. CRNKOVICH: Thank you.

MS. HOMAN: All right, well, thank you.

MS HANLON-BOLTON: OK, our next speaker is Regina Staudacher from Howard & Howard.

MS. STAUDACHER: Good afternoon and thanks for having us back. It is a pleasure to be here. One of you said this is a sacrifice of our time and it's really not. It is really a refreshing experience to have the opportunity to talk with all of you and to listen to all of our colleagues so thank you for listening.

My name is Regina Staudacher. I am a partner with Howard & Howard attorneys. I, as well, was back here on Valentine's day and you are correct. There is a lot of energy in this space right now. We have established more than 20 opportunity funds in Qualified Opportunity Zone investments and frankly I think — we're at 25 as of June 30. From everywhere from Las Vegas to Flint, Michigan, and what I am bringing to you today are just a few of the challenges that we have noticed in setting up those structures and a couple — many of them have been addressed today so I will try not to go in too deep on those comments specifically but some of those challenges, is the way I would describe them, would be with the debt finance distributions that appear to be trapped in the April regulations associated with the modified disguised sale rules.

The use of tangible property outside OZ locations, as it relates to qualified opportunity businesses, the ability to recycle gains and we've talked about this a tad as it relates to the multi-asset funds, but the ability to recycle gains that are triggered from the sale of underlying assets during the 10 year holding period continues to be what we view as a — continues to be an area of great disparity in terms of investors that want to come into these funds as opposed to family offices that might be utilizing targeted investments to set up their own funds so I think we are achieving different things by not allowing this recycling of gains within the 10 year hold period.

Next would be the ability utilized. Related party transactions and I haven't heard a comment on this because it seems to be pretty settled in but in working with family offices and closely held businesses, one of the things that we have identified — and these were not in my prepared comments so I am happy to prepare something separate on this, is that related party sales where businesses have sold out or bought out family members or individuals within that are related purely because of sibling relationships or other type of relationships, those are precluded from doing investments into Opportunity Zones.

In particular, what's interesting, we are finding is that a lot of those same type of family offices are no longer — are not able now to contribute those gains into high qualified community projects that would be unrelated to the transactions or the parties that created that related party gain so I would compel you to give that some consideration.

And I also have two additional comments. I am not much of a policy person but I have — we have gotten comments back from many of our investors as it relates to the need for an intermediary to connect investors with projects and opportunity funds. Essentially a match maker of sorts to put projects and investors together. I know this is not the time and place but I bring it up that we are often asked about this very concept. We attempt to do that, we can't be part of the promote, that's not what we do but there is definitely a gap between the community and the investors in terms of how to find each other for qualified projects and investors looking for qualified projects.

Lastly, we are working with some social impact investment funds who are specifically looking for advantages to invest in women owned businesses and minority owned businesses throughout Opportunity Zone locations. This is completely absent from the regulations and again, I understand, this is not your place but I mentioned that in terms of if there could be a way to align other incentives for those types of entities within the Opportunity Zone legislation or an ability to coach the communities on how to, again, match make some of these minority businesses and/or women owned businesses with investors. I think aligning some of these incentives would make this legislation that much more powerful to the people that need access to capital that currently don't have that.

So, the debt finance distribution comment. I'll address that quickly. I know Mr. Cullen and a couple of others addressed that comment. I can speak to a specific example of an investor with a $48 million gain from 2018 that had a fund set up.

We actually — as of the week before June 30th — abandoned that transaction for a large development in Minneapolis, specifically because of the new debt finance distribution language associated with the disguised sale modification.

That created a big problem. We had banks that were willing to take part of that transaction and so I was very interested in the conversation earlier in terms of looking at what the third party market will do with an Opportunity Zone investment and their willingness to participate and I think this is a perfect opportunity for us to enlist established banks that want to work with these developers and work with these investors to leverage that interest so that we can do distributions and then subsequent projects along within that structure.

So I think that's one that definitely needs further contemplation and I did go into some more detail on my prepared comments on that. Second to that is the use and location of tangible property. I think Mr. Glickman made comments regarding use and we again — this is one of the areas, as it relates to Qualified Opportunity Zone businesses where we are finding the 70 percent use of tangible property is a bit prohibitive as it relates to businesses with mobile units, for example, mechanical contracting companies with vehicles that run across the use of the tangible property is often used outside of the Opportunity Zone so the 70 percent test of the tangible property creates a problem if we want to relocate or acquire a mechanical contracting company or even a technology company where they have portable laptop or things of that nature.

So the ability to better utilize the testing for businesses would be very helpful. If we really want to put headquarters and businesses in zones, and still allow them to service their customers outside the zone.

The last comment I would make — as I mentioned earlier as the game rollover within the 10-year holding period — I won't address that anymore other than again stating that I think that is what is preventing multi-asset funds from really getting off the ground, at least in terms of our investment base and the funds that we have set up. The inability to reinvest and have gain transactions throughout the life of the tenure holding period seems to be the primary issue that investors are staying back and the lack of clarity around what would be that taxing event during the 10-year holding period.

Lastly, again, from a policy standpoint, just make the comment that we represent U.S. Hispanic Chamber of Commerce and Executives from one of the only Latina SBICs in the country who served corporate sponsors such as the Billion Dollar Roundtable and it's there where we feel that there is a need for additional incentive to support investments with minority businesses and women-owned businesses.

So with that, I'll reserve the rest of my time for other speakers.

MS HANLON-BOLTON: Do you have a suggestion on the 70 percent use test? How we would clarify that?

MS. STAUDACHER: Yeah, I think there it's really looking to the nature of the business, really needs to be contemplated, and I keep going back to when we talked to our clients that looked at the intent of the statute and so it's really about the fact that if we go on an asset-by-asset basis test and do the testing, we run afoul of that testing, so I would think something — really the percentage is challenging when you think of a mechanical contracting business, with let's say 200 or so service professionals and I bring that one up just because it's one that we are working on right now where they actually constructed a facility in an Opportunity Zone and they have all of these vehicles that are out running around and service professionals and they do some business on water repair, frankly, in Flint, Michigan and some outside of that zone.

They will fall outside of that 70 percent test, or fall beyond the 70 percent test as it relates to their tangible asset, yet the heart of the company is in the zone and that's where their revenues are generated and all of these others so I don't — I think that the linkage of 70 percent to tangible assets is what the issue is so I don't know if it's the amount as much as it is looking to the underlying business and what is really driving the business and why it's located in that zone.

MR. CRNKOVICH: Regina, thank you for your comments. What if we drill down on that example? I want to make sure we are not missing something with — something referred as the disguised sale rule. It's really a rule that limits the amount that is being invested. Looking at the disguised sales rules as a handy mechanism for that determination.

So if you could just tell us a little bit more about that fact pattern — so someone was going to invest 48 million?

MS. STAUDACHER: Yeah, so we had a 48 million dollar gain transaction in 2018 that was ready to be deployed by June 30, 2019 —

MR. CRNKOVICH: So let's call the individual at 48 million.

MS. STAUDACHER: It was a partnership but yes.

MR. CRNKOVICH: OK, and that partnership was going to invest 48 million?

MS. STAUDACHER: Into their own opportunity fund.

MR. CRNKOVICH: OK.

MS. STAUDACHER: And invest into a new development in Minneapolis.

MR. CRNKOVICH: OK, so 48 million down?

MS. STAUDACHER: Yes.

MR. CRNKOVICH: And they had financing lined up?

MS. STAUDACHER: Financing lined up with a single bank that has banked them for a number of years.

MR. CRNKOVICH: Right, and that bank was going to loan money to the QOF?

MS. STAUDACHER: Exactly. And, interestingly, looking to the underlying asset, which would be the new development.

MR. CRNKOVICH: Right, and was there an intended distribution of some of those proceeds?

MS. STAUDACHER: That's where we got caught up, right? There was intended distribution initially because they roll over and do additional investments.

MR. CRNKOVICH: So just to —

MS. STAUDACHER: It's really the two year period that's the issue.

MR. CRNKOVICH: Well, it's a disguised sale.

MS. STAUDACHER: Yeah.

MR. CRNKOVICH: And then also if you're comfortable under the normal facts and circumstances with all the disguised sale rules then you get comfortable with this. Within a short period of time, we are going to distribute say half of that amount so 48 million was invested, they are going to borrow 24 and distribute it out immediately?

MS. STAUDACHER: What's interesting about that is it wasn't — that part of the plan was not defined. It was the normal business process would have been for there to be a distribution.

MR. CRNKOVICH: Well, I know operating — yeah, but they are under the disguised sale rules —

MS. STAUDACHER: It could have been as much as half, yes. It could have been — in terms of the question being what would the plan have been because we abandoned it, it would have been as much as half of the 48 million to go back.

MR. CRNKOVICH: And just so I am not missing the obvious point here, the source of the proceeds say 24 that would be distributed, the source was — was it the borrowing? Was it operations or a combination thereof?

MS. STAUDACHER: It would have been the borrowing itself, yes.

MR. CRNKOVICH: And that was prearranged from day one?

MS. STAUDACHER: Yes, and what's interesting about that project specifically is that they have a track record of developing projects within 12-25 — in fact they do government contracts and so they have defined projects that must be constructed within a period of time.

MR. CRNKOVICH: Mm-hmm.

MS. STAUDACHER: So their project would have been completed before the end of this year, which is why the bank was very comfortable with that transaction.

MR. CRNKOVICH: So —

MS. STAUDACHER: So in our mind, it's all about there being economic substance to the underlying transaction —

MR. CRNKOVICH: Right.

MS. STAUDACHER: — that makes that — so our request is — the way it's currently written, it appears that there is a presumption of a disguised sale and if we can get over there being a presumption of a disguised sale, I think we could have gotten them comfortable.

MR. CRNKOVICH: And just to be clear, we are not within the disguised sales rules, that's the mechanic for purposes of determining the amount of the qualifying investment so 48 was going to go in, and maybe we can clarify this and thank you for your accounts, if 48 goes in and let's say there's a prearranged deal with the bank to borrow 24 and immediately distribute that out but the rules intended to deal with is to take the $48 million investment and say that if this would be a disguised sale based on the rules we put in the regs, then the 24 million distribution would actually reduce the amount of the qualifying investment.

It would have no impact on the underlying fund. It would just say that effectively you've put in 24 and the other 24 came from borrowing so again, it would just (inaudible) down the amount of the investment. That's all (inaudible).

MS. STAUDACHER: Yeah, what's unfortunate about the way it resulted for us is that instead of doing then the quality opportunity fund, what they did is split it up between some 1031 and other transactions but otherwise, they were looking to do with that 48 probably 3 OZ developments, right?

MR. CRNKOVICH: Mm-hmm.

MS. STAUDACHER: But instead they didn't have the clarity, at least we weren't able to find the clarity that they needed to be able to pull it out without that being treated as, you know, a not eligible gain.

MR. CRNKOVICH: OK, thank you.

MR. NOVEY: OK, sorry, I just want to make sure that I am not missing an opportunity. Your concern about the transaction between siblings.

MS. STAUDACHER: Mm-hmm.

MR. NOVEY: Would like to invest in a quality opportunity fund? That would appear to be facially inconsistent with the statute.

MS. STAUDACHER: Correct.

MR. NOVEY: Do you have anything that lets us satisfy what you need?

MS. STAUDACHER: I don't see it there either. I think it's an unfortunate result and I understand the intention of it.

MR. NOVEY: Again, I am not saying that it's a perfect statute —

MS. STAUDACHER: Yeah.

MR. NOVEY: — but in terms of where we have elbow room to try to accommodate things that everybody wants to see, when the statute is this clear, that doesn't seem to be a constructive use of our brain power to find a way around.

The next — the idea of essentially the QOF being a little bit like an IRA —

MS. STAUDACHER: Mm-hmm.

MR. NOVEY: — in terms of free redeployment of assets into their most economically productive location. It's great economics but unless there is a general and explicit provision that realized gain does not get recognized —

MS. STAUDACHER: Mm-hmm.

MR. NOVEY: — as there is with an IRA, as there is with a variety of other cases where Congress, if they want it to be tax free, they know how to say it —

MS. STAUDACHER: Mm.

MR. NOVEY: — and there doesn't seem to be an opening here for that however desirable you feel it would be, other than our saying (inaudible) with the code.

MS. STAUDACHER: Mm-hmm.

MR. NOVEY: Is there an option that we could go with other than ignoring the (inaudible)?

MS. STAUDACHER: Well, we have given that some thought as well in terms of the way that the step up and basis works for the first seven years. If there would be some corollary to even a recovery of bases on that second investment as opposed to a complete nonrecognition of gain, that would be the only — that would be a mechanism that would could demonstrate that there could be some recycling of the original —

MR. NOVEY: You are suggesting that the basis step would get sacrificed and extra basis could go in and show some —

MS. STAUDACHER: Yes.

MR. NOVEY: And then finally, is there something that we have done that makes the ozone incentive less hospitable than it could otherwise be to these other goals? In other words, we tried to make it available to a variety of other kinds of taxpayers — for example (inaudible) we can imagine being a (inaudible) we could put that in there because it's a responsibility (inaudible). The absence of a back end gain, which would be an unusual development for a real estate investment that has been (inaudible) affordability.

Is there anything that we have done that makes this regime less hospitable than it could be or is it simply that we haven't manhandled the natural consequences (inaudible) that could be —

MS. STAUDACHER: I don't — I think — again, I come back to the spirit of the legislation when we are looking at — advising our clients so I definitely am hearing your comments in the regulation about the spirit of legislation and that's where I can find comfort with our clients in terms of steering them in the right direction. It's when we get into some of the particulars —

MR. NOVEY: The tax lawyers —

MS. STAUDACHER: I understand that (laughter) but I think it's when we get into the nuances and the traps that aren't obvious that then three months go by trying to figure out what's the right answer and now we've lost another year of an investment.

MR. NOVEY: Mm-hmm.

MS. STAUDACHER: So I think to the extent that we can embrace the spirit of the legislation and I am not concerned about the table sitting here.

We are all concerned about five, seven and 10 years from now, sitting in front of an IRS exam and having to explain the spirit of the intent was appropriate and yet is being interpreted differently. Right?

MR. NOVEY: We will try to make it explicit when we are able to further the intent within the constraints of (inaudible), but the basic structure was caused by enactment and it wasn't something that otherwise (inaudible).

MS. STAUDACHER: Understood.

MS HANLON-BOLTON: Thank you.

MS. STAUDACHER: Thank you.

MS HANLON-BOLTON: Our next speaker is Maurice Daniel of Economic Inclusion Task Force.

MR. DANIEL: Good afternoon. Thank you for the opportunity to speak to you today. My name is Maurice Daniel, I am here as a replacement for my colleague Moses Boyd, who was originally scheduled to give this presentation, but he had unforeseen travel complications. So I am a poor substitute, but I am here nonetheless.

Moses and I are a part of the Economic Inclusion Task Force, a stakeholder group whose aim is to see the proper implementation of the Opportunity Zone legislation. We're committed to assisting the rollout of this new investment tool that was, of course, created by the 2018 Tax Cut and Jobs Act.

The Economic Task Force is composed of African-American men and women entrepreneurs, formed following the White House meeting with Vice President Pence and U.S. Senator Tim Scott in the spring of 2017. The Economic Task Force advocates for advocating the economic growth in urban communities, and we have worked hard for the passage of the Opportunity Zone legislation.

We believed then — as we believe now — strongly and resolutely, that the Opportunity Zone law for the first time in decades opens the door for much needed major capital investments in the urban role and heavily African-American concentrated communities. In this regard we are keenly interested in two vital goals: ensuring that the program operates to the benefit of the intended communities, and ensuring that there is significant diverse participation at every level of the program, including at the fund formation levels, ownership and management levels, and with the business enterprises that will be the subject and recipients of these capital investments. The specifics of the Treasury's regulations are crucial to achieving these outcomes.

We would like to express our support for certain provisions that we believe are critical for these objectives, and we applaud Treasury for its tremendous work in implementing the regulations for advancing this law.

We also believe that the Department has achieved much needed progress in clarification matters that are providing more confidence to investors who are eager to engage in this new national investment tool. However, we do remain concerned about several issues. The regulations regarding the investment in operating businesses and substantial improvement tests and the proposed 31-month requirement for determining active trade of businesses.

Regulations regarding investments in operating businesses and the substantial improvement test application. This issue concerns the determination of substantial improvement tests either on an asset basis or an aggregate basis. The Department's notice of proposed rulemaking indicates that this test will be applied on an asset-by-asset basis. However, given the nature of the target communities and what it's going to take to attract capital and realize successful investments in these communities, it is vital that the Department allow for the meeting the 31-month substantial improvement test on an aggregate basis as opposed to an asset-by-asset basis.

For example, if a QOF determines to build a healthcare business part in a Qualified Opportunity Zone, the assets will likely include adjoining commercial structures and parking lots. On an asset-by-asset basis, each of these assets would have to meet the test individually. However, no rational investment strategy would operate this way. Only allowing for accounting on an aggregate basis do we believe that such investments are more likely.

The proposed 31-month requirement for determining an active trade of business, the notice of proposed rulemaking suggests that the new investment and a new operating businesses and acquires and must be an active trade or business after 31 months of the deployment of capital. However, given that these investments are incurring in distressed and in many ways (inaudible) markets for the purpose of major private capital investments, it is highly probable that it is going to take longer than 31 months before such an enterprise will meet the test of an active trade or business.

Consequently, we agree with the position of others who have commented on this issue, that the Department strongly allow for the satisfaction of this requirement in the event of clear evidence of advancement of the investment for the active trade or business has been made, and on other safe harbor requirements for the capital have been met.

I would like to raise one other point as it relates to concerns that have been expressed to our group from local community groups, local organizations, and NGOs play a strong role in attracting investments in these targeted areas. They've struggled with achieving clarity from the complex regulations in a plain and English manner.

They're concerned about finding what they need in the regulations, understanding what they find, and being able to interpret what they find to meet their needs. We at the Economic Inclusion Task Force would ask that the regulators consider these concerns, and in the future clarifying statements.

Thank you for the opportunity to speak to this hearing. And in addition we would like to comment that we are co-signers with the Economic Inclusion Task Force and with the Economic Innovation Group Coalition as well.

MR. NOVEY: There is an asset in the — is it the cluster of O-zone communities in (inaudible) that needs substantial improvement. And the company puts a fair amount of program money into that, but not the (inaudible).

MR. DANIEL: But not that.

MR. NOVEY: But there is additional moneys that by the same business, in let's say downtown Silver Spring, right near the D.C. line, (inaudible). It doesn't seem to be consistent with the purpose that those two expenditures would be put together as a single qualifying substantial improvement. So we need help deciding when an aggregation rule, if we were to adopt one, should be accommodated so that it really is meaningful in terms of substantially improving a particular asset, even if we don't do it on an asset-by-asset basis. So we need that help.

And we try to write as clearly as we can, but we have to write technically and specifically. And we hope that others such as your organization can have experts like you who read it and can then help translate it to the people that are waiting for it.

MR. DANIEL: I certainly appreciate the dilemma and the restrictions that you are operating within, and don't take them lightly.

We always go to the mission of the legislation as our guiding light. And I don't know if I have all the answers, but I know that there's an answer and we're willing to work very closely with the regulators to find it.

MS HANLON-BOLTON: We have Sarah Brundage from the Enterprise Community Partners.

MS. BRUNDAGE: Hello. My name is Sarah Brundage, I'm the Senior Director of Public Policy for Enterprise Community Partners. And on behalf of Enterprise I want to thank you for this opportunity to offer comments.

Enterprise is a leading provider of the development capital and expertise it takes to create decent affordable homes and rebuild communities. Since 1982 we have raised and invested $43.7 billion in equity, grants, and loans, to help build or preserve nearly 585,000 affordable homes in diverse thriving communities. And Enterprise is launching our own family of qualified opportunity funds intended to advance equitable and inclusive growth in the communities where investments are made.

To ensure the tax benefit fulfills its intent, Enterprise recommends that the IRS modify proposed regulations to 1) clarify the treatment of vacant land to prevent land banking, 2) encourage paring with the low-income housing tax credit and new markets tax credits, and 3) implement requirements to collect and publicly share meaningful data on qualified opportunity fund investments.

To the first point regarding the treatment of vacant land to prevent land banking, we believe that is subtracting the value of land from Qualified Opportunity Zone property for purposes of the substantial improvement test would be conducive to efforts to preserve affordable housing. However, that same provision could unintentionally result in predatory land banking and long-term landholding. Such an outcome would contradict the goal of making improvements to acquire QEZ property. This is particularly true in areas experiencing rapidly rising costs, and the potential for abuse would be especially problematic in the case of land that is vacant, significantly underdeveloped, or with significantly depreciating assets.

We therefore recommend that the IRS clarify that in the circumstance where property is being used for long-term housing tax credit properties, the requirement to substantially improve property comply with Section 42 requirements, which are 20 percent. And with the exception of circumstances with the housing credit, we recommend that the IRS provide a threshold above which land would have to be substantially improved, regardless of any assets or buildings on the property. Without such clarification it is possible that investors would be able to receive a significant tax benefit for holding valuable land for 10 years without making improvements.

And I imagine that you might ask me what a specific number for such a threshold would be. And Enterprise did not provide a specific number, however, we would be happy to default to our partners at Novogradac who are speaking after me, but I believe also recommended that at least 20 percent as well.

On the second point, Enterprise believes that the true potential of Opportunity Zones lies in the ability to pair this new source of private capital with existing programs to generate social impact. In particular, the low-income housing tax credit and the new markets tax credit are proven powerful tools with long track records in community revitalization.

This round of proposed regulations included provisions that could inhibit the industry's ability to pair these tools, however. The original legislation allows investors to elect between paying the tax on either the original deferred capital gain or the fair market value of the Qualified Opportunity Zone investment in 2026.

However, the proposed regulations differ from the original legislation and instead require investors to elect between paying the tax on either the original deferred capital or the capital gain that would result from the sale or transfer of the QEZ investment.

So we strongly urge the IRS to ensure the viability of pairing these incentives, and in particular ask that the IRS clarify that the fair market value, excluding debt, plus any cash flow distributions to investors, be the standard for calculating a deferred tax bill in 2026 for long-term housing tax credit projects. And we believe clarification on these regulations would allow housing credit projects to compete with market rate projects and help us maximize the impact that we can have in low-income communities by leveraging other federal programs.

We also recommend adjustments to the proposed regulations stating that the actual corporate subsidiary with the capital gain has to be the one that makes the investment in a QOF. This could be problematic for banks that invest in housing credits through a community development corporation but which may have capital gains in another corporate affiliate. Therefore, we recommend that the IRS allow taxpayers investing in qualified opportunity funds that then invest in low-income housing tax credit partnerships to use capital gains from consolidated affiliates of the taxpayer.

Lastly, we once again urge the IRS to collect and publicly share meaningful data on QF investments. We thank the Treasury for its prior RFI on data collection and tracking for Qualified Opportunity Zones, which we are very pleased to provide our recommendations to. We believe the collection and public reporting of meaningful data on QFs and their investments into designated Opportunity Zones are critical first steps towards ensuring that the Opportunity Zones tax incentive is fulfilling its intended purpose. We provided detailed recommendations on requesting requirements that we hope you take into consideration.

So with that, thank you, and we appreciate your time and consideration.

MS HANLON-BOLTON: Thank you.

MR: CRNKOVICH: No questions.

MR. NOVEY: Is there something other than the debt finance issue which you think we could do to facilitate the pairing of the tax incentive here with (inaudible) and NCC?

MS. BRUNDAGE: Yeah. Good question. So as I stated, I am on our Public Policy Team, and we ask this of our loan fund team, and it has been proving difficult at times to pair the two. And this was the only technical recommendation that we were able to identify.

MR. NOVEY: OK. Because when you look at it one of the things you notice was that there are some of the benefits that many get excited about for O Zones, which I would be surprised if private investors were looking forward to. Unless the person who has worked with new markets, but there were also changes. There were aspects which didn't seem — at least no low hanging fruit in any number had to be there. The other one, in terms of what the amount to be included in 2026 is, I assume that you would not say that the QOF could load up with debt, distribute that out, do so because of the basis of their debt, and there would be no income to the investor. And then the start-up amount would be reduced close to zero because of the presence of the obligation of the debt. That didn't seem to be something we were thinking would be advocating and not everything is really consistent with what the —

MS. BRUNDAGE: Yeah, I don't believe that's our intent, yeah.

MR. NOVEY: So in other words the heartache, if I could call it that, which is produced by looking at what would be the result of getting rid of the debt that is internal to your entity, is the necessary concomitant of a generous rule which allows, at least after that first two years, a distribution without tax based on the predicated, the tax-free nature of that distribution would be predicated on the basis that it is derived from the internal borrower. And I'm willing to bet that we are not getting requests saying that we give up the ability to make those distributions if you would give us a net of debt rule for 2026.

MS. BRUNDAGE: Yes, that is not our intent. Thank you.

MR. NOVEY: OK. Thanks.

MS HANLON-BOLTON: Thank you, sir. OK. So next up is John Sciarretti from Novogradac Opportunity Zones Working Group. And once John is done we're going to take a 10-minute break.

MR. NOVEY: Anybody that has got airplanes to catch and things like that, come up and —

MS HANLON-BOLTON: You're up, John.

MR. SCIARRETTI: Good afternoon, everyone. I'm John Sciarretti from Novogradac Company. And today I'm representing the Novogradac Opportunity Zone Working Group. On behalf of the Working Group we are pleased and want to thank you for our opportunity to give our testimony today.

Today I'm going to discuss three topics, none of which are original, going 13. But I think it's great that we're aligning in our interests today. The three topics I will be discussing will be the special not includable rule in the case of an inclusion event for investments in QOF partnerships and S Corps. The second topic is the special 10-year exclusion election, which has been talked about a lot today. And then lastly I'll talk about a grace period for QOFs and QOZBs to use property in a trade or business.

So with respect to this special not includable rule, just a little overview. The regulations provide a special rule for an inclusion event, the inclusion amount, with respect to passthroughs. It's a little different than the statutory provision in that in the statutory provision you take the lesser of the fair market value or remaining deferred gain less the basis in investment. Where with passthroughs you take the lesser of the amount of the deferred gain less basis or the gain that would be recognized on a fully taxable dispositioned investment.

We understand why this rule was proposed, that it is intended to prevent taxpayers from avoiding recognizing deferred gain when the fair market value of their investment is diminished due to debt finance distributions. That's what we understand why the rule was presented.

However, as Sarah indicated, it is adversely affecting the investment and affordable housing and other high-impact community investments. With the 10-year gain exclusion, as Mike's referred to, it is generally less valuable to them as they don't expect to have appreciation in their investment, or much appreciation in their investment, at the end of 10 years. However, they were pretty excited about the 2026 inclusion rule — the statutory rule — because it did provide value, and that they could recognizes this sort of typical loss in value over time at a certain date. So it gave them an accretion and basis. In my experience in working with a lot of these low-income housing investors, they were excited, we were seeing nontraditional investors coming to the table. And, you know, a lot of plans were being made for funds with syndicators and the like, and as soon as the proposed regs came out it's been quiet. You know, folks have sort of walked away or stepped back from the Opportunity Zone. And so as a result, I think we have inspiring investors have actually turned away from the program.

And so we're recommending — as I think Sarah referred to — we're aligned in this, that we make the inclusion rule in 2026 consistent with the mechanics of the statutory rule, but that we modify the definition of fair market value. And that we use the net value of investment, excluding debt, and then add to that distributions that were made. So it means distributions that folks may have made to reduce the value of their investment. We propose that we add these distributions back which we think prevents this artificial reduction in investment without adversely effecting affordable housing and other community impact type investments in these zones. So that's our first issue.

The second issue is with respect to the 10-year exclusion election, which, as I said, many people presented this issue today, and that this proposed rule only applies to capital gains. It only applies to the sale of property by a QOF, not the business. It excludes gains realized from the sale of property that's characterized as ordinary income, like 1245 appreciation recapture. And it also excludes any gains that are attributable to the sale property at the business level.

And so it's not on the same page. We think that the rules should be synthesized with the rule for selling your QOF interest, where all gains attributable to the appreciation of property, all property, whether capital or ordinary, or whether the property is held by the QOF or the business, are eligible for exclusion.

It's common — as it's been said much today — it's common, especially in multi-asset funds, to exit by selling assets. There's also likely to be a significant amount of operating businesses that will sell assets that produce ordinary gains. We see that in the market, especially in the renewable energy space. And then, because most of the Qualified Opportunity Zone property, in our experience, is going to be held by a business, not the QOF, simply because we have this flexibility of time to make our investment. And with the working capital rule, we think that it's important that we synthesize these two rules and expand the gain exclusion to apply to all gains attributable to the sale, any property used in a trade of business by a QOF or QOZB. With the exception of inventory or assets that are held for sale in the ordinary course of business, which is inventory. That was our recommendation.

And then lastly, which was sort of hinted on today, with respect to a grace period for QOFs and QOZBs on the use of property in the trade or business. And generally I think folks have talked about it, grace period for a Qualified Opportunity Zone business to become a business. And the statute does sort of allude to that in that the statute says that new businesses must be organized for purpose of being an Opportunity Zone business. So they're acknowledging that there is sort of this start-up period at the business level. But we know that Qualified Opportunity Zone business property must be used in a trade or business to be considered qualified.

And we do have some sort of safe harbor, within the working capital of safe harbor, that allows you to sort of treat tangible property as existing, even before you bought it. But there's really no discussion on use, and there's no discussion on how much time a business gets to use the property. So if a fund invests in equipment, let's say, and, you know, there's a period of time before they can actually put that in production, you know, does that disqualify property at that point in time, or do they actually have to have it in production? Or even in the case of real estate where if a business kind of satisfies the safe harbor, but in 31 months it's not placed in service yet, and so do they fail the Qualified Opportunity Zone property at that stage because it's not placed in service yet?

And so we think the Treasury should consider a rule where a business is not treated as failing to satisfy the use requirements solely because the tangible property is not used in a trade or business before a reasonable start-up period. All businesses are different, it's probably, you know, 12 months might be good for some, but some it may be different based on the nature of the business. And so before a reasonable start period based on the facts and circumstances is sort of what we're recommending, that a business should have time before they have to use their property.

Alternatively, if you do want to provide a safe harbor, provide that businesses have 12 months, but that 12 months doesn't start until after the 31 months. So that's our suggestion. And we're really suggesting this both at a QOF and the QOZB level because even at the QOF level we have to use this property in a trade or business.

So that completes my testimony today on behalf of the Working Group.

MS HANLON-BOLTON: Thank you, John, for your comments. There's one thing that keeps popping up for me. I was on a panel with Mr. Novogradac, and there seems to be a lot of push to have sort of special rules for affordable housing areas, just to make it work. I know Jill talked about historic credits, and I've been asked about new markets.

So I don't know if someone could provide me, or provide all of us, something with specific rules that you're looking for just for this industry. Because it keeps coming up and it's all over the place.

MR. SCIARRETTI: Well I think that — I mean in my experience I think affordable housing worked well with this program, at least certain types of affordable, you know, bond probably worked better than, the 4 percent probably worked better than 9 percent. But I think that investors are sort of relying on the fact that they are losing value in their investment and the benefit that they don't get at the end of 10 years, they can sort of accelerate this loss in value in 2026 and it provided enough incentive to encourage nontraditional investors in the space. Because we saw it happen — I mean there were, people were pretty excited about it.

And so it's not what you can do to help, it's what you did do to hurt. By giving us that rule, you know, and I think you modify that rule, and I understand why you did that rule, because generally folks could reduce the value of their investment by taking distributions before 2026. And so we suggested one way to modify that. There may be some other ways that don't hurt folks, you know, that are not trying to lose the value of their investment, but naturally the value may, you know, not be appreciating, at least at 2026.

MS HANLON-BOLTON: Well the reason why I ask, Mike and I are very familiar with this space, but a lot of us on the panel, and decision leaders, might not be so familiar with the space. And so I think it would be helpful to highlight those issues.

MR. SCIARRETTI: Yeah. That's the one thing I can think about, but I think it's something that as a working group we could convene and come up with some written response to answer that question.

MS HANLON-BOLTON: Thank you.

MR. CRNKOVICH: Thanks, John. Two really quick hits. First, on the calculation of the game, I just want to make sure I'm understanding where you're coming from. But suppose I invest $100, or roll over $100 or whatever term you want to use. So my outside basis is $100, I look at the statute, look at the deferred gain, 100 bucks over the basis.

MR. SCIARRETTI: Wait a minute —

MR. CRNKOVICH: I have $100 of gain that I —

MR. SCIARRETTI: Outside would be zero.

MR. CRNKOVICH: So my outside basis is zero, I put $100 in.

MR. SCIARRETTI: Yeah.

MR. CRNKOVICH: So my turnaround — and it was suddenly 12/31/2026 — putting aside 10 and five percent bump ups, I'd have to pay tax on the $100 gain though?

MR. SCIARRETTI: Right.

MR. CRNKOVICH: So I want to make sure I understand where you're coming from with the borrowing. If my gain is 100 and it's tied into that gain, less the basis, and there's a borrowing without a debt for the distribution, I am now going to have a basis in my partnership interest of $100. Right?

MR. SCIARRETTI: If there's a borrowing —

MR. CRNKOVICH: If there's a borrowing, $100 of which is allocated to me, $100 borrowing is allocated to me.

MR. SCIARRETTI: Right, on the inside.

MR. CRNKOVICH: Borrowed $100, borrowed that is allocated to me.

MR. SCIARRETTI: Yeah. You have $100, yeah, that's correct.

MR. CRNKOVICH: Now do I have a preferred gain of $100, I have a basis of $100 in my partnership interest, right, and I don't think you're suggesting it but I just want clarification. One way to read the statute, literally, is to say the excess of the gain, deferred $100, over the basis of $100, is the amount you pick up on 12/31/26.

MR. SCIARRETTI: No, I think you have to go net, net on that. You can't include that in your basis.

MR. CRNKOVICH: So the question really is when you walk through your calculation, adding back distributions and so on, is that written in your testimony?

MR. SCIARRETTI: It is. It is. Yeah.

MR. CRNKOVICH: OK, good. OK. And then back to the same old question on the -2C 10-year rule. It sounds like you're trying to get parity between a sale outside and sale inside, right? Except that to the extent there's any of the gain is attributable to property held primarily for sale on a sale outside of that clearly would be excluded?

MR. SCIARRETTI: That's true.

MR. CRNKOVICH: But inside it would not be?

MR. SCIARRETTI: That's right.

MR. CRNKOVICH: Right. So you're not looking for total parity.

MR. SCIARRETTI: Not total parity. I mean you could always just make a big inventory sale after 10 years and get it excluded, you know.

MR. CRNKOVICH: Right. And again, I've asked others, but would you be in favor of a rule that would require the distribution in order to avail yourself of — I don't know if it's a 10-year rule for sales inside?

MR. SCIARRETTI: Yeah. The first I thought about that was when you asked others. And I'm trying to figure out, other than creating parity, what else does that — it doesn't solve anything.

MR. CRNKOVICH: OK. I just wanted to —

MR. SCIARRETTI: Yeah. Right, right.

MR. CRNKOVICH: OK. Thank you.

MR. SCIARRETTI: OK. Thanks.

MS HANLON-BOLTON: OK. All right. So let's take a 10-minute break. It is now about 2:29, so be back here at 2:40.

(Recess)

MS HANLON-BOLTON: All right, why don't we get started for the last half of this public hearing? So we have five more speakers. And so our next speakers are Joseph Darby and Christina Rice from the Boston University School of Law; my hometown.

SPEAKER: We had that Professor Atlas was the co-author of the —

MR. DARBY: Right, Professor Atlas is — she decided not to have it look like the the Mamas and the Papas.

But anyway, my name is Jay Darby. I'm a tax attorney, proud of it. On behalf of Boston University School of Law we're going to make a presentation. Joining me is Christina Rice, who's the director of the BU Graduate Tax Program, the LLM Program for the School of Law. Also joining us is Professor Susan Atlas, who helped pull the submission together.

We teach at BU what I'm positive is the first full credit course specializing exclusively on the Opportunity Zone Act, you know, code sections.

MR. CRNKOVICH: Please send us your syllabus.

MR. DARBY:: We will. We're making it up as we go, but it's the first semester, obviously.

MR. CRNKOVICH: Modifying it after.

MR. DARBY: Oh, yeah. Well, you'll appreciate this. I was helping with the ABA and with the Novogradac Group and with the Real Estate Round Table, all answering questions and saying, you know, these are the things that Treasury specifically asked for comments on, which there's a long list. And I said this is perfect, my work is done. So I sent it out to the students and said everybody pick a question to answer. And so we got back, you know, 12 answers from 12 students, we put it together in 48 hours. It's got a few typos in there, but it was kind of fun.

So we're going to talk about a bunch of things fairly quickly. I'm going to talk about 1231, which is a particular important issue that I've been sort of advocating for in every group I've been part of. And then Christina is going to talk about vacant land and I'll come back and do kind of a drive-by presentation on the rest of the topics.

The 1231 issue you're familiar with. The treatment of capital gain came out in the first set of regulations and was treated in a very generous, reasonable way with the special rules for partnerships. The 1231 rules kind of create a lot of stress and tension in the real-world marketplace.

I have two people who in April sold businesses. When you sell a business, you'll have often capital gain and 1231 gain on the same day from the same transaction. And for these people I suddenly — after the regulations came out — they did this before the regulations came out, I said, oh, my gosh, they got 180 days from April 1 to invest the capital gain and they can't invest the 1231 gain until, you know, December 31 at the earliest. And it just didn't — it doesn't work in the real world of reinvesting capital investment.

I think that I understand the issue of 1231 gain being netted against 1231 loss. If it's a negative number, it's an ordinary loss. If it's a positive number, it's a capital gain. There is an issue about splitting in there, but I think the statute itself is very clear that it's the sale of property, you know, the gain from the sale of property to an unrelated party. It doesn't distinguish between what kind of property it is. We have identified it should be capital in nature, but obviously, investment into capital assets, which is what 1231 property is, is the kind of capital we're talking about, redeploying capital from other parts of the economy into the Opportunity Zones.

And I think it makes all the sense in the world to have the exact same rules match up as between capital gain and under 1221 — 1222 of the code and the 1231 assets. And I think it's a very reasonable statute. It seems to suggest that there is — on the issue of the splitting of the capital — of the 1231 gain and the 1231 loss, there's a very clear provision in code section 1231(c), which I think, Mike, we've even talked about in the past, about treating the — if you've got a capital — a 1231 loss, it carries forward for five years. And it converts future 1231 gain into ordinary gain and it's designed to match up.

And one of the things we have in our suggestion, which I think is a very good one, is to the extent that there's any possible game-playing where you're sort of, you know, rolling over a 1231 gain tax-free for seven years and harvesting a loss, if we just extend it as one of the elements of electing to have that benefit, you know, extend the rule till 2026, so that when you have to recapture your 1231 gain, I think, again, we all agree if you have a 1231 gain being reinvested, you recognize 1231 gain in December 31, 2026. I think that's logical. If you've got sort of split losses, you had ordinary losses you've claimed in the meantime, this would come back as ordinary gain, and so there wouldn't be any mischaracterization or game-playing.

There's only a timing issue, which is what 1231 is all — what the 2026 rule's about anyway, really, is a forbearance of the tax until, you know, December 31, 2026. So I think that that rule is solvable, and it's pretty necessary. There's just a lot of transactions where people are having, you know, capital gain and 1231 gain the same day. And they really don't even have an overlapping day in the year when they can invest it into a single thing.

One other thing I'll teach you — I'll count as a teacher is people don't know the difference between capital gain and 1231 gain. They don't understand what really is the nuance between them. If you have a — there aren't that many kinds of property that actually produce 1231 gain. Real estate does; tangible property almost never does. When you're buying machinery it does down in value, not up.

The only other kind of property you see besides real estate that goes up in value is typically intellectual property, patents and the like. And I teach taxation of intellectual property at BU and I can tell you that patents can be ordinary assets, capital assets, or 1231 assets depending on who created them or how they're acquired. And the fact that a patent can have all three characterizations just bespeaks to the fact that having complicated exchanges between 1231 property and 1221 capital assets strikes me as is going to only cause creation.

People are going to make mistakes all the time, and I'm not just talking about taxpayers, I'm really talking about tax advisors, tax professionals, who are at the moderate- to low- to mid-levels of practice aren't really going to know the difference. So it doesn't make any sense to have a distinction that's only going to cause noncompliance on a massive scale.

So that's my thoughts on 1231. Let me have Christina come on and comment on the vacant land issues.

MS. RICE: Thanks, Jay. So I will be representing the students in this class. I am sort of a quasi-student myself, talking about the vacant property.

So the second set of proposed regulations provided that vacant structures or other tangible property other than land will satisfy the original use requirement if the properties have been vacant or abandoned for at least five years. We agree that some quantifiable minimum period of vacancy is necessary to prevent potential abuse of this favorable guidance allowing vacant property to qualify as original use property. However, we believe an uninterrupted period of five years is unnecessarily long, and that a shorter period of one year is sufficient to achieve the antiabuse goals.

There is also a strong public policy need to reduce this period. Cities and towns across the U.S. have recognized the negative impacts of vacant and abandoned properties, including increases in crime and vandalism, decreases in surrounding property values, increased risk to health and welfare, and escalating municipal government costs. We cite several studies in our report that have found a correlation between the length of vacancy and increased crime, decreased property values, and higher municipal government costs. Local government officials, community organizations, and residents across the country recognize the value in putting vacant land and abandoned properties back into productive use as quickly as possible.

It's extremely doubtful that property owners who held vacant property prior to designation of zones in early 2018 intentionally arranged a vacancy with any future tax incentive in mind. We, therefore, recommend that Treasury adopt a standard similar to that applicable to enterprise zones, which states 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.

For property that was not unused or vacant before the designation of the tract as a Qualified Opportunity Zone, we anticipate that few, if any, property owners intentionally sought to make otherwise productive properties vacant in 2018 or 2019 in expectation of favorable treatment, especially in light of the proposed five-year rule put forth by Treasury in the second guidance. Therefore, we think a one-year rule is also appropriate for property that became unused or vacant after 2017.

To the extent that prospective one-year rule provides an incentive to abandon property, it will be mitigated by the reduction in tax benefits for anyone waiting at least one year from the issuance of final regulations to act on a vacancy strategy. There is a tradeoff in policy objectives in this case and we favor a policy that helps rescue vacant buildings to the greatest extent possible.

MR. DARBY: OK. And then as they say on the TV game shows, this is the lightning round. I've got quick comments.

Unimproved land: I thought you guys did a great job; 162 is the exact right way to test whether it's being pulled in and used in a good way. It's not being held as an investment asset, it's being used.

A quick observation: You were concerned about somebody buying agricultural property, you know, growing grapes or whatever and doing the exact same thing, you know, haven't really done much to improve it. I agree with that, as well.

I think there's two things you could do as an addendum. One is it has to be used in the trader business and then either it has to be a different trader business, meaning you're taking flat farmland and turning into parking lots or swimming pools or something else, or there's some level of improvement. And you had a good standard, it was improvements that are not insignificant. I think you're probably having some kind of safe harbor. It's a minimum of 20 percent, it's a safe harbor, but a facts and circumstances test.

For people, as you pointed out, with land in general, there's all kinds of reasons people acquire it and use it. Is this a bona fide use to acquire it included into an overall improvement to the community? I think that that was extremely well handled. That's the only sort of small tweak I'd make there.

On leasing rules, you nailed it. The leasing rules are fabulous. The only thing I'd comment there is that on the market rate lease, you proposed a 42 standard. I wouldn't use 42 for unrelated parties. As you pointed out about real estate, there's a very diversified world out there and if people are at arm's length negotiating a lease relationship, it should be respected.

I did agree with you on the 12-month minimum — maximum on prepaid leases for related parties and the other rule of related parties. I thought all those rules plus the alternative valuation method were just absolutely perfect.

On the trader business issue under 162, I think you're wrestling with it like everybody else is because 162 is the right standard for trader business. The active conduct is a ringer for all of us. It gets pulled in out of 1397(c). It isn't even in the O-Zone Act anywhere. The active trader business gets pulled in by reference to 1397(c), which itself doesn't define what active trader business is, just to start out, making it as ridiculous as it could possibly be.

You got a range of stuff. It could be the very low threshold of the new markets credit, which is basically any effort to make a profit basically is an active trader business. O-Zone has got a much higher thing on — I think triple net leasing is really the — where it is.

I think 162 is the standard. And we look at the Hazard case — the General Counsel Memorandum 38799. And the IRS has acknowledged it's a very low threshold to turn leasing plus a little bit more into an active business for tax purposes. And if that's where we end up, that's OK. It's just that the issue of — I'm sorry, I've got to be quiet. The — merely engaging in triple net leasing has got everybody sort of rattled that if you can't do triple net leasing, you've identified I think 162 as the standard. So it's triple net leasing plus a little bit more. That'd make the world turn in the leasing world.

Thank you very much for giving us the time.

MS HANLON-BOLTON: Thank you. Any questions for the panel?

MR. NOVEY: One quick question on the 1231 issue.

MR. DARBY: Yes.

MR. NOVEY: One of the pain points, I guess you would call it, that we've been hearing about is that if the seven-year basis bump is available only prior to 12-31-26, we were hearing a lot of folks having only one day on which one can make investments with respect to 1231 gain deferral that would be available for the seven-year benefit was pretty tight (inaudible). Some of your predecessors at that podium have suggested that the seven-year and five-year benefits put appropriately within the statute ought to be available beyond 2026, even though the deferral had ended.

To what extent would that relieve part of the challenge of the 1231 timing question? And it would relieve your concern about your capital gains and 1231 being triggered on the same day, but having the different 180-day period.

MR. DARBY: Yeah. I don't really see that as the driver of this issue. There's two kinds of gains in this world: Capital gains and 1231 gains. And they're both gigantic amounts, in the potentially trillions of dollars. And having them have dramatically different rules — and I will guarantee you, people can't tell the difference.

Ordinary taxpayers, forget it. Every one of them told me they sold a capital asset and it was real estate. OK, depreciable real estate, so it wasn't, it was 1231. And so I talk to accountants, they go, oh, yeah, that's right. You know, the accountants aren't even that sharp on it. OK? So we're going to have mistakes all over the place.

The logic of being able to treat them consistently I think is in the statute is a sale of property. They're both property sold by a taxpayer to an unrelated party. So that's why I really advocate. We're going to have a lot of errors otherwise.

MR. NOVEY: So somebody who has a 1231 gain — let's say in the first half of the year makes the investment in the QOF within 180 days (inaudible).

MR. DARBY: Right.

MR. NOVEY: If it turns out when they're filing their return that they don't have capital — that they have some 1231 losses and, therefore, their net 1231 gain is less than what they had thought they were going to have, they simply cannot defer that much. They will end up with a mixed investment and that's OK?

MR. DARBY: No, I like having the 1231 gain be eligible because it says in the statute — you had it exactly right on capital assets. When you sell, then you have 180 days from the date of the sale, and that's just clear in the statute. It's clear it's an asset-by-asset sale.

Same rule because they want to drive capital into investments and Opportunity Zones. It's already a slow enough train as it is. You got 180 days, plus you got the QOF level plus the QOZB level of 31 months. But, you know, being able to invest it as quickly as people want to after they have — they recognize a gain event and roll it over is the right way to start it rather than pushing it as much as a year later.

And I think the logic of it is — I'm not so worried about the net. I mean, you net capital gains and capital losses, and we're not worried about the fact you may have, you know, less capital gains at the end of the year than the amount that you invest from a specific disposition. Likewise with 1231, if you have a 1231 loss you can claim it. But, again, I'm proposing, first of all, you've got a five-year wait. Any capital — any 1231 gain you recognize for the next five years is converted to ordinary gain.

And I think it's entirely appropriate to say if you have 1231 losses in a year when you roll over 1231 gains, you know, you're effectively instead of netting it and then rolling over the lesser amount, just have it be recaptured as 1231 gain in 2026 and extend the loss rule. You know, but by your election you agree to have the subject of the loss recaptured under 1231(c) through December 31, 2026. It all matches up. It really does nicely.

MR. NOVEY: So your proposal basically is that 1231 gains, you treat them the same as capital gains.

MR. DARBY: Exactly the same, including the partnership —

MR. NOVEY: Regardless of whether or not for that year there was only a penny of net loss or net gain.

MR. DARBY: That's right. And it reconciles December 31, 2026. And if you've had 1231 losses and gotten ordinary losses, you'll recapture it as ordinary gain, which is exactly what the 1231(c) rules do, which is fair. You've got a deferral. They recognize a deferral throughout the concept of the first of the three tax benefits. And it comes back begin recaptured in the right character at the right time. So I think that'd be a fair rule for all concerned. It'll drive deals. It really will make things happen.

Thank you very, very much. Anything else?

MR. NOVEY: Thank you.

MR. DARBY: Good.

MS. BOLTON: No, I think we're good. Thank you very much.

Our next speaker is John Lettieri from EIG Opportunity Zones Coalition.

MR. LETTIERI: Good afternoon now. It seems like just yesterday we were together on Valentine's Day, so it's great to see everybody again. Thanks for having me back.

My name's John Lettieri. I'm the president and co-founder of the Economic Innovation Group, a bipartisan research and advocacy organization. We were deeply involved in the idea behind Opportunity Zones and worked closely with the policymakers to get it passed, so we have a deep interest in today's proceedings.

EIG also works with a broad coalition of stakeholders around the country and it's that work that's informed the detailed comment letter that we submitted in response to the latest proposed rules. I want to speak to some of those recommendations here today. And one of the casualties of being I think 15th in the lineup is that it has all been said, so I'll try to skip over pieces that are particularly redundant, but also emphasize a few things that I think are particularly important.

First, I just want to take a step back. I think we've already seen the fact that opportunities on this — unique opportunity. Let's overuse that word, to make progress in expanding beneficial outcomes and economic activity for long-term residents around the country. Even today, as we sit here without full regulatory clarity, this policy's already supporting investments as wide ranging as clean energy investments, (inaudible) workforce housing, manufacturing companies, agribusiness, food start-ups, technology incubators, and the list goes on and on. And I think that speaks to some of the potential of this policy, particularly once we have regulatory clarity in a mature marketplace, but also underscores why this proceeding is so important because to one of the questions that was asked earlier, if we want investment to go far and wide around the map; if we want it to go to nontraditional places; and if we want to go into deals that are particularly difficult to execute, the rules are going to have a lot to say about how much risk investors are willing to take with committing their capital over a 10-year period or more.

Particularly, in areas that are dis-invested and have a stroll with long-term decline. So, the work you do and are doing is critical to expanding that of investment and economic opportunity and we commend you on work you've done so far.

So, as I mentioned, while the incentive was designed to support a wide array of needs across communities, we believe its central purpose really was to facilitate investment in local operating businesses. Particularly, new ventures and small- to medium-size local businesses in need of growth. This central goal must be thoroughly reflected in the final rulemaking in order for Opportunity Zones to achieve the success that they could achieve over the next decade.

To this end, a second round of proposed regulations made enormous strides in addressing key structural questions and definitional issues, particularly those related to operating business investment that had been holding back the formation of the opportunities known as marketplace nationwide. So, our coalition applauds the efforts of Treasury and the IRS to resolve a wide range of complex issues so that opportunities can work as intended. For example, the proposed safe harbors for the gross income test, the extension of the working capital safe harbor provide much greater certainty for operating businesses and will serve the underlying goals of this statute quite well (inaudible).

However, I want to focus my comments on areas we believe require additional clarification of the final regulations, so I want to get upfront, we were very pleased and thought that second round did an exceptionally good job of addressing the key questions. So, don't take these comments as anything but — let's just narrow the playing down to the issues we think really require some additional attention. And because the second tranche proposals covered so much ground, most of the recommendations I'll make today really amount to relatively small technical clarifications or tweaks, minor refinements or clarifications, but I hasten to add while relatively minor in scope and complexity, these changes are nevertheless critical to the real world success of this policy and the communities depending on it.

First, I want to talk about the substantial improvement test. This is a central feature, as you know of the opportunities on statute. Now, its purpose is to ensure that investments made under this incentive lead to new value creation and new economic activity in the designated areas. In the preamble, Treasury asked for comments on the advantages and disadvantages of applying this test on an aggregate rather than asset-by-asset basis. As many others have already commented, we believe the aggregate basis test approach has many practical advantages and is consistent with the meaning and purpose of the statute. It is also consistent with the manner in which business actually expand their operations in the real world.

On the contrary, the asset-by-asset approach is deeply impractical. We believe it imposed massive and unnecessary compliance burdens and would reduce the economic benefits to the designated communities by discouraging investment in those local businesses. So, we believe strongly that the final rule should adopt a substantial improvement test on the aggregate basis. This, perhaps, no more important — unresolved issue to our minds to date than this one. It will otherwise be nearly impossible to operate businesses to satisfy substantial improvement tests. So, we recommend two potential safe harbors as have, I believe, the ABA and other commenters in our comment letter that reflect a real-world utility of an aggregate basis test.

First, assets purchased as part of the same investment decision and located within the same track or contiguous tracks should be treated as an aggregate asset for the substantial improvement test. Second, for either operating for real estate businesses, assets operated as an integrated unit should be aggregated.

Next is time and flexibility. This is a key issue for the practical application of this policy in terms of raising capital from investors to pooling capital into qualifying investments and returning capital to investors after exiting investments held for 10 years or more. While the six-month exemption period for newly received capital included in MPRM is a big step in the right direction, we recommend extending the six-month period to at least 12 months, which is particularly important for the formation of multi-asset funds. In the same vein, funds need time to wind down and liquidate their investments after 10 years and guidance should permit opportunity funds sufficient time to do so without facing the penalty for failure to meet the 90 percent asset test. We provide detailed recommendations in our comment letter on how to do this.

Next is nonqualifying property. Clarity is needed regarding how to treat nonqualifying property for the purposes of the 70 percent substantial threshold. For example, many projects contain some modest amount of nonqualifying property, such as land or a structure that was purchased before 2018, or purchased from a related party, or a pre-acquisition development cost incurred by a related party and capitalized to the property. We do not believe that the presence of nonqualifying property should taint the entire project, but rather should be treated as a separate asset for the purposes of the substantially held threshold. In addition, if property is overwhelmingly improved, we support treating it as entirely new originally used property. In our comment letter, we discuss a potential 80/20 standard and safeguards for achieving this.

Next is the working capital safe harbor. Our coalition has supported the regulations expansion of the 31- month working capital safe harbor to include activities related to the development of a trader business. We raise two issues in our comment letter that we urge you to consider with respect to this safe harbor.

First, the extension provided for delays related to governmental action is welcomed, but should be broadened further to provide relief for other events beyond the business' control, such as natural disasters, delays in obtaining permitting or licenses, supply shortages, and so on. Second, we ask the Treasury to clarify in the final regulations in an active trader business, need not exist at the end of the first 31-month safe harbor, but rather as long as the quasi-business is making progress towards the active trader business and is still within the safe harbor, it satisfies the requirements outlined in the statute.

I'm going to skip over 1231 again because I associated myself with everybody else's comments on this. It's a big issue, it's a big concern and we hope that you'll take a close look at that.

Look, next, we want to look at quasi-business subsidiary sales. We applaud the proposed regulations providing clarity on the ability to exit opportunity fund investments after 10 years, either by selling opportunity fund extending both the role permitting the sales of assets by the opportunity fund and the rule interests or assets. However, the additional clarity is needed for the assets sold by the lower tier opportunities' own business. We suggest protecting against hot asset treatment to assets held by the lower tier opportunities' own business. In addition, we have strongly agreed on the need for the proposed rules to permit reliance on the exit rules. This is a big issue that is holding back formation of multi-asset funds.

Lastly, I want to report on two things, reporting requirements and anti-abuse rules. Well, not the scope of the MPR under question today, I want to note that we appreciated Treasury's issuance of a clarifying reporting requirement and urge the adoption of data collection framework to govern opportunity fund investments and to track those over time. We believe such reporting requirements are essential in preserving the integrity and demonstrating the efficacy of opportunities on the coming decade of the (inaudible). And lastly, we support the use of broad anti-abuse rules to ensure the integrity of the emerging opportunities on this market and note that these rules should be sufficiently clear so as not to discourage real economic investment of low-income communities. Our comment letter includes several recommendations to curb abuse while providing clarity to investors that they are in compliance.

For example, we believe that final regulation should require that a greater percentage, 90 percent, of the tangible property owned or leased by a real property quasi-business must either be located within an Opportunity Zone or contiguous to an Opportunity Zone. This 90 percent threshold would be in addition to the 70 percent asset test which would remain otherwise unchanged for all purposes of the section. And this would help ensure that the economic activity of real estate businesses is truly benefitting the opportunities on its surrounding area.

So, in conclusion, our coalition recognizes and appreciates the hard work of the IRS and Treasury in establishing a regulatory framework for this nation's policy and look forward to answering your questions.

MS HANLON-BOLTON: Thanks very much. Next up, we have Mark Troppe from the State Economic Development Center.

MR. TROPPE: Good afternoon and thank you for the opportunity to testify today. My name is Mark Troppe. I work with the Center for Regional Economic Competitiveness in Arlington, Virginia. And I'm here representing the State Economic Development Executives Network where the S-E-E-D, the SEED Network. The Network is made up of top state economic development leaders from across the country who gather on a bipartisan basis to discuss issues of mutual interest and it won't surprise you one bit to hear that they're very interested as one of their top priorities is learning about and being involved in and engaging their states in the opportunities that come with Opportunity Zones.

At your February hearing, the SEED network was represented by Stefan Pryor who was from Rhode Island, the secretary of commerce and Kurt Foreman, the president and CEO of the Delaware Prosperity Partnership. The SEED Network did submit a letter commenting on the second tranche of proposed guidance. It was signed by 16 state economic development directors and today, I'll summarize some of the comments that were submitted and going number 16, on the day it really does feel like some of this is going to be repetitive, but I'll — I want to make sure to emphasize these five points in particular that they thought were especially important. And I want to add that while some of the SEED Network's membership had the privilege to select Opportunity Zones in their respective states and others had inherited the zones from a prior Administration, all of them are equally and actively, eagerly engaged in working on operationalizing Opportunity Zone program.

In the main, we would like to express

today the Network's hope for changes that enable the program to serve both real estate development and the fostering of operating businesses and a number of other folks have stressed that point in particular. It's critical to make sure we — that the regulations support, track investment to both. So, the five main points that we wanted to convey.

Number one, the rule should provide additional flexibility in determining the substantial improvement requirement has been met through applying the requirement on an aggregate basis. The preamble in the proposed regs provide that the requirement is determined on an asset-by-asset basis. The determination of the requirement on an asset-by-asset basis rather than aggregated by especially burden operating businesses. And this could make the Ozone investment process difficult in ways that were not necessarily intended. We encourage that the substantial improvement requirement be applied on an aggregate basis rather than asset-by-asset basis with respect to operating businesses which we expect will decrease the burden for those operating businesses.

Number two, the rule should provide sufficient flexibility for opportunity funds to reinvest in interim gains in Qualified Opportunity Zone property in a timely manner without incurring a penalty or trigging a taxable event. The proposed regs provide that the proceeds from the sale of Qualified Opportunity Zoned property that generates gains may then be reinvested — but the gains subjected to income tax — and while we understand that the regs indicated the IRS doesn't have the regulatory authority to exempt those gains, we strongly encourage revisiting the issue. Because we're concerned, the main concern that preventing opportunity funds from reinvesting capital proceeds from the sale of qualified stock and partnership interest without triggering a taxable event would reduce the incentive for opportunity funds to invest in operate businesses specifically.

Under the draft regs, the incentive for opportunity funds to invest in operating businesses could be diminished due to the taxation of those interim gains even if the gains are reinvested into qualifying Ozone properties. And some states have noted from among our members that the current regulations' treatment of interim gains as significantly curtailed interests in their states in investment and operating businesses when compared to interest that's being expressed and shown in real estate investment.

This topic was raised by the Network in previous comments. We believe that the regulation should reflect the kind of basis investment practices where a diverse portfolio of investments is wise. There's an ebb and flow to the investment. We're particularly concerned that opportunity funds be given the ability to reinvest capital proceeds from the sale of qualified stock in partnership interests in the Ozone businesses without triggering a taxable event. Future regs or modifications to the regs could provide further flexibility for opportunity funds to reinvest interim gains in qualified Ozone property in a timely manner without subjecting to income tax on such gains.

Number three, the rule should provide sufficient flexibility for new opportunity funds to meet the requirements of the 90 percent asset requirement. Allowing recently contributed property a minimum of 12 months before it counts against the 90 percent asset would provide additional flexibility for funds to thoughtfully establish their investment portfolios. And under the proposed rules and opportunity to finally apply the 90 percent asset requirement without considering any investment received in the preceding six months.

In practice, this means that a fund has a minimum of six and a maximum of 12 months to deploy new capital raised before being subjected to a possible penalty for failure to satisfy the requirement. In a typical investment timeline, it takes the fund a minimum of 18 to 30 months to raise capital for investors and to appropriately deploy it across the balance portfolio.

So, the network is very grateful that the most recent tranche of regulatory guidance provides a degree of flexibility with respect to cash held by an opportunity fund regarding the 90-day 90 percent requirement as well as the flexibility that the 31-month working capital safe harbor provides as well. However, as we stated in earlier comments, we recommend a change to allow a minimum of 12 months for investments to be made before incurring a penalty under the 90 percent asset requirement and we ask that you consider extending the option to disregard recently contributed property to contributions or exchanges that occurred not more than 12 months before the test from which it is being excluded, rather than the six months in the current regs, establishing a minimum of 12 months for those investments to be made. While the working capital safe harbor is beneficial to newly established funds, the suggested change would also afford multi-asset funds additional flexibility and allow for a more realistic investment timeline for the funds.

Number four, the rule should encourage, but un-intrusive public reporting requirements for COIF. And due to the unique aspects of the program, it's important to track the efficacy of Opportunity Zones and identify areas of improvements and modification for the future. So, we suggest that opportunity funds be required to provide a set of simple information, enough to give the public confidence about the initiatives. We encourage the adoption of some simple reporting requirements to collect data on funds and their investments. In our December 2018 letter, we proposed that they be required to report at least on the specific Opportunity Zones in which there is capital deployed, the amount of capital deployed, the eventual appreciation of that capital. Beyond that, we're very interested in the RFI process and the responses that come forward in that and we look forward to some of the insights that those responses may provide.

Last, but not least, under additional opportunities, one issue that we did not address in our written comments, but some states have more recently raised as a potential area for improvement, and I know there's many other groups that have also submitted written comments to focus on how the regulations could better encourage affordable housing development. And while the Network has not recommended specific regulatory changes, we support creative approaches that would enable investments in affordable housing projects and make it easier for opportunity funds to invest in LITEC projects. Some states have expressed concerns that there may be issues with the regs around compatibility with the development of low-income housing, so the SEED network would encourage you to explore this and we would be very interested in having further dialogue with you on that particular topic.

In closing, defenses tracks were selected because they are, in many case, struggling. Facing challenges in attracting investment is extremely important to the network that we recognize that the important — that the purpose of the program is to attract investment. Both for real estate and for operating businesses and that the regulations support both purposes and we really appreciate the progress that we've seen in the subsequent versions of the regs and appreciate the opportunity to share the thoughts of our networks with you here today.

MS HANLON-BOLTON: Great. Any questions?

MR. NOVEY: One. What were two of the limitations do you see that we should address in election pairing deals on incentives —

MR. TROPPE: LITEC, so this is an issue that has just come to our attention in recent days and I would be happy to talk with the members in the states that have expressed those concerns to come back with some specific items. I noticed you raised that earlier today, so we'll check with some of our members and get back to you on that.

MR. NOVEY: OK. Thanks.

MR. RIMMKE: You had mentioned that you were looking on the 90 percent asset on the initial testing date going from six months to 12 months, but then I think you also said, or at least I wrote down that it takes an average of between 30 months to actually deploy capital in many cases. Is 12 months going to be sufficient, or just like increment how (inaudible) working capital would that be sufficient?

MR. TROPPE: Good question. Yeah, I don't know. I — our members expressed the concern that 12 months would be more — the sentiment that 12 months would be certainly more workable than what we have now. Will it be sufficient? We didn't broach that. I'd be happy to get feedback on that point as well.

MS. HANLON-BOLTON: Great, thank you.

MR. TROPPE: Thank you.

MS. HANLON-BOLTON: Thank you very much. OK, Number number 17, Clayton Wyatt of the Alliant Asset Management.

MR. WYATT: Afternoon. Something about being in an auditorium with no cell service for five hours with all of you. I feel like I know you all better. So we're happy to be here. My name's Clayton Wyatt. I'm Chief Capital Officer of the Alliant Companies and our affiliate is Alliance Strategic Investments and our partner Eddie Lauren is here. We've been following this legislation very closely as part of the EIG Group and the Novagratic Working Group and so we echo those statements that were given earlier and I'll keep this very quick because I know we're very close to being done here.

There were a couple of things that we just wanted to highlight. And a quick background on Alliant. We're a 20 year plus tax credit syndicator, so we've been in the lytic business as an assets manager, developer, fund manager, and now in these preservation funds, and the funds in the Opportunity Zones are of particular interest. So we actually, I think, had done the first, if not one of the first tax credit Ozone deals which was done in Florida with a bank we were lucky enough to have an investor partner in SunTrust that had an episodic gain from a division that they had sold. So they had a capital gain that they could put in and we actually structured it. We don't see that as the norm, and unfortunately, in the regs, you know, the type of gains that these banks are going to have are not going to qualify for investment.

So I know there was a couple options that were given earlier and some ideas. We'd love to, you know, converse a little bit more on ideas on how to attract things and because I do think that it's a big miss if we don't have banks that are interested in investing in these areas. So one of those areas I wanted to hit — I know it's not necessarily in the purveyance here or in the scope of what you guys can do — but the CRA credit. If there was a way to attract these banks in by giving them CRA credit in these areas, I think that would go very far to helping to attract more capital into this space.

So the other two items that I wanted to cover was on impact reporting and then on the substantial improvement test. Again, you know, I think this has been covered generally here, but one of the things that we really feel strongly about as an affordable housing developer and a tax credit syndicator is that one of the most impactful investments you can make is to give residents in these areas a safe, a clean, you know, place to live that they can afford.

And so as part of that I think that requiring, you know, some sort of reporting at a project level would be very helpful, which should include things like the address, the number of units that were created at an affordable level, population served, and the average incomes of the residents that occupy those units.

As far as the, you know, drawing the banks and, again, I think as I mentioned under CRA, you know, banks have been a driving force in the tax credit housing space and, unfortunately, we don't see them coming into this space in scale. That's going to be episodic investment, so I think if we can figure out, you know, again, this isn't a letter to you guys, but being able to get that CRA credit would go a long ways.

And then lastly just to hit the substantial improvement test as it relates to existing multifamily housing it's been very difficult, as you would imagine, to substantially improve an existing property. And, unfortunately, that's a lot to the product that actually needs some of the improvement. These are, you know, old buildings that have a high occupancy. And even though you could come in and do a very large improvement you're not going to probably spend 100 percent of what you bought these products for.

So if there was a way to — under the change of use rule — to figure out that you could take an unrestricted multifamily housing project and change the use by putting in use restriction on that property, and you could do that through the form of a land use restriction. So if you could have a lura and, again, this is done — negotiated state and local levels, but if there was a template for that nationally that could come "off the shelf" and we could apply that to existing unrestricted properties and under the statute and the definition of change of use restrict the use on that property, and then you wouldn't have to spend 100 percent of the property that you purchased.

I think you could create and preserve a lot more units in these areas. I echo the statement about the aggregate test on substantial improvement. There's definitely opportunities where you go buy a property with some adjacent land and put a new building on that land and operate those two buildings as one unit and qualify the aggregate test, but being able to do something a little more creative where we can take the existing housing stock where you don't want to remove tenants in a building for five years, or even one yea,r to qualify that would really open up what we call this naturally occurring affordable housing or NOAH so that we could use the existing housing stock that we have. I'll stop there if there's any questions.

MS HANLON-BOLTON: Any questions?

MR. NOVEY: In terms of attracting Ozone investment by having a CRA (inaudible) very, very little opportunity. So are you talking about investing in CRA even if (inaudible).

MR. WYATT: Correct. So, you know, as you may know as a tax credit syndicator we have economic funds and we have CRA driven funds, and so we see that banks will invest for that CRA need, particularly in certain areas where it's difficult for them to get that requirement met. So if there was a — and, again, I would go back to this land use restriction. If we could have a template that was off the shelf so if you say you're creating housing in these areas and maybe you're serving 60 to 120 percent of AMI and you have this use restriction that would meet the, you know, the regulators' threshold I truly believe banks would invest just for that, without getting the benefit of the OZ incentives they would invest to meet the need of their CRA requirement.

MR. NOVEY: I see, so you aren't suggesting that somehow we find some subset of banks gain from sales of debt which would you say for this purpose be treated as a capital gain?

MR. WYATT: I mean, listen, if there's a way to do that it absolutely would help. I think this could be an easier way to do that that might be lowering it for —

MR. NOVEY: But we can't control CRA.

MR. WYATT: Agreed, but you asked the question.

MR. NOVEY: OK. Fair enough. Fair enough.

MS HANLON-BOLTON: Just real quick on your issue of unrestricted versus restricted use. I mean, my thought was always that we could deal with this at a lower local that they would be doing for zoning, but what you're asking is for a national level?

MR. WYATT: Yeah. The problem that we've seen — and we've taken existing properties — we're working on one here in the D.C. area where we're trying to put a use restriction on a building and that helps, you know, from our investor base, help for a number of things, for our impact, you know, mission. But it's hard to negotiate on a one-off basis what that use restriction is. And so, again, having this generic template that banks would have confidence in knowing that if this template is set on this building it's just efficient, it's quicker, it's easier. It just becomes a standard. There's a lot of those things that we'd know early.

You've seen investors that are hesitant to invest because there is no standard. There's a lot of uncertainty. Eliminate some of that uncertainty with a standard that can be duplicated and used all the time.

MS HANLON-BOLTON: Anybody else? MR. WYATT: Great. Thanks.

MS HANLON-BOLTON: All right. Thank you very much. Last, but not least, Julia Gordon from the National Community Stabilization Trust.

MS. GORDON: Hi. Good afternoon. Thank you so much for the opportunity to testify today and it is sort of fitting that I go last because I'm going to talk about the thing that is either last or nonpresent in conversations about Opportunity Zones which is single family residential housing, particularly in the home ownership context.

My organization, the National Community Stabilization Trust focuses exclusively on single family residential properties in distressed neighborhoods nationally with an enormous amount of overlap with Opportunity Zones. We've been doing this for 10 years. During that time we have facilitated that transfer of 26,000 vacant residential use, mostly for home ownership, some for affordable rental. So that's where we're coming from.

Typically when I testify I, like many of the folks you've heard of today, am a subject matter expert and I can talk statutes and regs with anybody. I come to you today to say I have no idea what I'm talking about. I don't do lytech. We don't have any tax credits, you know, beyond, I guess the mid which doesn't really apply to the affordable folks that we deal with. We don't have a tax credit program that helps us finance the acquisition and rehab of these properties.

When we saw Opportunity Zones happen it was not a conversation we had been in previously, and it is a conversation that's taking us a long time to figure out how to break into. But we are hoping two things, first, we would love to find a way for these funds to provide the kind of well-priced capital to our developers that make the difference between being able to do this rehab and not do this rehab. But if we can't achieve that we want to advance the principle of first do no harm.

So I want to speak a little bit to some of what we're already seeing as what may be some unintended consequences of the Opportunity Zones program. We are seeing, basically, a speculative land grab in Opportuntity Zones, and we are seeing that that is not confined only to either commercial or multifamily rental properties. We're seeing it in the single family context too. If you look at Zillow prices you'll see that in Opportunity Zones you've seen something like a 20 percent rise in home values or, you know, Zillow generated home values, for what it's worth, in those neighborhoods.

We hear from our local partners, we have local partners all over the country, community development corporations, folks like that. We hear from our local partners that they're seeing new behavior in Opportunity Zones. For example, they're seeing tax lien holder foreclose on these liens at unprecedented rates within an Opportunity Zone when that behavior isn't changing outside the Opportunity Zone. So we are a little bit on alert about this whole thing.

Something that may not be that familiar to you because it's not what you do every day is that since the financial crisis in 2008 not only did we see close to 10 million home foreclosures on families, but the vast majority of those properties have never become reoccupied by an owner occupant. They have transformed into single family rental properties. The single family rental industry has become turbocharged in the last decade. It's being helped along, you know, not only by the fact of all of these foreclosures and the availability of those properties in, sort of, the normal course of business events, but by massive sales of pools of distressed mortgages, by FHA, Fannie Mae and Freddie Mac, by technology advances that have enabled investors to purchase residential properties without ever seeing them, and without living anywhere near them. You can have, you know, I can tell you stories about people with laptops in China buying properties from the Detroit land bank and then they find someone to go look at the property and they're like "Can we give it back?"

So this is really threatening to us. Everything that folks are trying to do to try to advance the interests of affordable home ownership. I don't need to tell the folks here that home ownership and the extent of home ownership in the neighborhood can often be the difference between successful revitalization versus, kind of, predatory and displacement oriented gentrification.

And I think if what we're really trying to do is to provide the kind of public benefits to these neighborhoods that we're talking about in this program we have to be very mindful of any effects on the single family market and anything we do that makes it far easier to deploy these properties as rental, rather than home ownership, and anything that undermines the requirement to properly rehab these properties. It is a little known fact that most vacant single family residential properties are not so called zombie foreclosures stuck in the foreclosure process. That only accounts for maybe 2 percent of them. The rest are investor held properties, something they're rented out, something they're just sitting vacant.

So I'm going to talk about two specific things related to the rule. And, again, I apologize that this really isn't an area where I'm a subject matter expert. First, vacancy. A number of folks have addressed this today and I'm going to address it as someone who is dealing with vacant properties every single day.

The first thing is we need a definition of vacancy. We have problems all the time in the work we do because of the multiple definitions of vacancy out there. The census, the United States Postal Service, Fannie Mae, Freddie Mac, pretty much every municipality, and pretty much every other lender out there has a different definition of vacancy. And this can cause a lot of problems, especially when it comes to property preservation and maintenance. And it certainly could cause problems with respect to basing an exemption of substantial improvement on vacancy.

Another terminology topic that I wanted to cover is the term land banking. You've used that term with respect to unimproved land to mean kind of the, you know, acquisition of land with, sort of, no intention to do anything in particular. I do want to note that land banking has really become a term of art in the last decade with the municipal land banking movement. Land banking is now really a process or policy by which local governments acquire surplus properties and convert them to productive use or hold them for long-term strategic purposes. This is a public purpose organization and we don't really want to see the term land banking associated with a behavior that we're more likely to describe as warehousing or even squatting or, you know, whatever. So I just wanted to make that point.

In terms of the number of years a property should be vacant before it's eligible for the exemption. If the property — everybody has already made this point. There is nothing worse for a community than a vacant property. Nothing. You know, the problems that come along with vacancy are legion, so for a property that was vacant prior to the Opportunity Zones program I don't see any need for any period at all. That property should be able to be put back into productive use.

Similarly, in the single family context and only in the single family context — after a property goes through foreclosure — it should be able to be eligible immediately. On the other hand, since what we have in many of these neighborhoods are hundreds, thousands, you know, hundreds of thousands collectively single family homes held by investors that have done nothing to improve these properties and really have just become slum lords. These are investors who will have absolutely no qualms about kicking out their tenant so they can sit around and wait for a period of years before they get the exemption.

I'm a little concerned that the five years is both too long and too short. You don't ever want to say out loud in a reg that something should be vacant for five years for any purpose. Because vacancy for five years is just, frankly, a disaster. It may be that, again, I can only speak for single family and the situation is very different for apartment buildings, for larger buildings that if you have a property that's being rented out like that it is highly likely it is need of the kind of investment where you really want to see substantial improvement in that property, and you may not want to exempt it at all. So, again, just for single family I'm going to put that out there.

The last thing I want to say because this is not my area of expertise, but we would like to see these funds to be able to be used for for-sale development. You've already put — you know, you have the 12-month recycling ability now, but that doesn't necessarily cover all of the taxable events that occur if you're running a business that's rehabbing and selling single-family residential properties.

We would suggest that there be — that you consider having a section of the reg that specifically addresses single family, because lots of these issues, you're kind of putting, you know, a square peg in a round hole when you're trying to talk about either vacancy or reinvestment periods, or the amount of time it takes either to deploy capital or to actually do the rehab, completely different for a single family than for a multifamily. So I don't — you know, I will be happy to work with you on that as well.

I'm running out of time, but I did wait a long day, so I will just — my last point is, I just want to underscore what everybody said about the importance of data collection.

You know, I have data that I've collected on 26,000 properties from hundreds of different single-family developers. It has been an enormously useful database for developing other statutory and other proposals related to single family. It is imperative that you collect, assemble, track, and disclose at least some minimum set of data.

I agree that the CDFI Fund may be the appropriate entity with the capacity to do this, and they could probably do it with information that is largely already being collected by the Funds and just needs to be reported.

Thank you so much for this opportunity to speak.

MS HANLON-BOLTON: Thank you. Do we have any questions?

MR. NOVEY: Just one. Which definition of vacancy or vacant would you recommend that we adopt because there are several in terms of (inaudible)?

MS. GORDON: So, I'll be honest with you, it doesn't matter that much, you just have to have a definition. The Postal Service definition is very expansive and includes vacancy, you know, it might be — and this is true for the census too — it might be vacant because somebody is on vacation, or on some kind of long-term medical care situation.

So, it has be to be a vacancy definition that's really oriented toward — what we're thinking of right now is vacancy when we talk about it, you know, I always think that Fannie and Freddie definitions are good ones, because they really cover so much of the industry. But again what matters more is to have an agreed-upon definition than particularly which one it is.

MS HANLON-BOLTON: All right, thank you very much.

MS. GORDON: All right. Thanks so much.

MS HANLON-BOLTON: So, this concludes our formal presentations. What we usually do in public hearings is we allow anybody else who wants to speak, who has anything to say, they can say it now.

MR. CRNKOVICH: Including one of the opposites.

MR. HAWKINS: So, as Mike just mentioned — my name is Shay Hawkins. I was one of the drafters of the Opportunity Zone Provision and Tax Reform that was based on the bipartisan Investing in Opportunity Act, which brought us all here today.

I'm here today in my capacity as President and CEO of the Opportunity Funds Association. We work with funds, investors and entrepreneurs to abdicate for reasonable expansions, the ultimate extension and preservation of the Opportunity Zone Provision.

And, you know, in my former role I had a good view towards congressional intent behind the program, and the intent was to get as much capital in the 8700 distressed census tracts as possible, and have as many investors and a range of different type of investors, as many entrepreneurs, a broad range of entrepreneurs are able to utilize this policy and benefit from it, as possible.

So, we want that far-reaching, far-ranging utilization was really key to rest my (inaudible) on this. And so as an example, you know, there may have been — been brought today, our association just like the other 200 people in the room were all part of the EIG's Coalition, so we echo a lot of what's been mentioned today, but I want to emphasize just as an example the — you know, the aggregation versus the asset-by-asset substantial improvement standard.

You know, I think that's a great example of if we hold to the aggregation standard that will bring in that broader range of entrepreneur, the broader range of business types that will utilize the policy, and a broader range of investment frankly that can ultimately get involved. And so I'd like to hold that out as an example.

And finally, you know, I'd just like to thank Julie, and Mike, and your teams, I'd like to thank you for everything you guys have done in terms of the implementation thus far. But then even beyond that, I wanted just to express appreciation the past year, and that we were, and in this year, and both an example of how seriously you take this process, how seriously you take this critical, critical policy, and how seriously you take those of us, who've taken the time to come here and testify today.

So I just want to express our appreciation. And anything you need from our association, and anything you need from the rest of us in the group, just let us know, because we are here to make sure this policy works for the people.

MR. NOVEY: Thank you.

MS HANLON-BOLTON: All right. Thank you very much, Shay. Anybody else?

SPEAKER: Yes.

MS HANLON-BOLTON: Go ahead, right here.

MR. LORIN: Hello. My name is Eddie Lorin, and I just want to emphasize one thing that, I got involved in the EIG and, you know, the Relic Coalition, for one reason. Primarily a rehabber of apartments, currently take like and make like. The problem with this legislation from day one is that this 100 percent test is going to do the opposite of what I believe this legislation was intended to do.

If we can do what Clayton suggested, if we're going to change the use, and I got this idea over dinner with (inaudible), so this is something I've been milling over, and trying to figure out how to make this work for almost a year-and-a-half.

If we can take the same regulation interpretation of a change of use from vacant to operational, and take that change of use from an unrestricted property to a restricted property with some form of (inaudible), which has to be off the shelf, because it's not so easy to come up with a template to create affordable housing.

But there's millions and millions of units that are going to continue to atrophy as the brand new buildings are built next door, because of the way this legislation is set up.

So, I strongly beg you to please consider the change of use from an unrestricted to restricted affordable housing so we can take those millions of units that are getting atrophy, and transform them into a good product.

Because if you can buy it, let's say in a major urban area at $200 a door, and you're building at $500 a door, what makes more sense? Well, that all makes more sense, but we still need to preserve that existing stock, or that stock is going to, again, just dilapidate.

And my suggestion is 20 percent. If you change the use from an unrestricted to restricted affordable housing, and you spend 20 percent of the capital on renovations that should suffice as a safe harbor for affordable housing.

Let's take the example of in D.C., you can buy something for let's say $200 a door, old product — the best-case scenario is $40 a door, is going to be the equivalent of your appraisal on your land.

So, now you're stuck with $160 a door, so 20 percent of that would be $32,000 a door, very significant renovation. But certainly you're never going to spend $160 a door, never. And that property will sit there and over the years will atrophy and become more blinded because there's no incentive to rehab.

So, sorry to bang this drum so hard, but I think it's critical that people realize this legislation may backfire for that very reason.

Thanks.

MS HANLON-BOLTON: Thank you.

MS. HARRINGTON: Hi. My name is Ashley Harrington. I'm the Director of Social Justice at UNCF, the United Negro College Fund. We are the largest provider of — the private provider of scholarships in this country, and we also represent 37 of the private historical Black colleges and universities in this country.

We got into this discussion, and we were interested in this work because half of our institutions are located in Opportunity Zones, and these are institutions that have been historically underfunded, and not invested at the levels that they should be.

And so if you're thinking about ways of encouraging business to work, not just with minority-owned businesses, we also think there should be encouragement to work with our institutions because they're better off in their communities.

For those who are not familiar with the story of the Black colleges and universities, there are 100 or more accredited HBCUs, public or private, concentrated in 19 states, the District of Columbia in the U.S., and U.S. Virgin Islands. They enroll almost 300,000 students, approximately 80 percent of whom are African Americans and 70 percent come from low-income families.

Only 10 percent of undergraduates alone in nonHBCUs is African Americans. And we account for only 3 percent of public and not-for-profit private institutions, but we award 17 percent of Bachelor's Degrees to African-Americans, and 24 percent of (inaudible) goes African Americans.

We annually generate over 109,000 jobs in our communities, and almost $15 billion in total economic impact. So, we think there are excellent ways to invest in their communities, and we think there's a reason most of them are in Opportunity Zones, and they are those bedrocks.

So, if you're going to affect the community around an HBCU in an Opportunity Zone, you can do that through our institutions. They are usually our largest employer, and not just for being agitator. So, thinking about that, for everyone in this room, but also and to think about how you do that in the regulations. Thank you.

MR. NOVEY: Thank you. What have we done or failed to do, that if we do or didn't do would better encourage the results that you're looking for?

MS. HARRINGTON: So, I'm also not an expert on this, but I think the normal type incentives that you use to encourage people to partner with certain folks I think, extra credits, extra —

MR. NOVEY: We're stuck with the statute bill because (inaudible) —

MS. HARRINGTON: Right.

MR. NOVEY: — and they did a wonderful job even though it was (inaudible). (Laughter)

MS. HARRINGTON: Yeah.

MR. NOVEY: But that's the sort of rules of the game that we have to operate in, and clearly encouraging not just the communities around vacancies, but also encouraging the institutions themselves would be a wonderful good, but the question though is to what extent does this statute give us a scope to do that?

MS. HARRINGTON: So I — again I'm not an expert in that — I'm happy to think more about this in the (inaudible), but one problem that I'll say from the institutional side that we've encountered, is that our institutions, because they are often so low-resourced, right, they are very risk-averse. And so much of this process represents a concern because it's new, but also there's potential risk not just for the investors but also for the institutions that they're working with the investors.

So, it's clarifying and thinking about ways to — the statute cannot giving the risk to everyone, but when you're thinking about HBCUs in particular, how to mitigate that risk because they do offer the public good beyond just somebody who needs, and they are definitely in the lead to probably a reduction in economic growth in their communities. And so I think to help we can — we are happy to help think about more specific ways you could do that in the regulations.

MR. NOVEY: Would love to hear it. MS. HARRINGTON: Thanks.

MS HANLON-BOLTON: Thank you. Anybody else? OK, right here. Let me get one right here.

SPEAKER: Hi. My name is Alan Walwork. And what I wanted to ask — I want to thank the panelists and the speakers for their insightful questions and comments. Particular, I was heartened by Mr. Novey's statement at the outset about how we could help Treasury and the IRS in its rule-making process, like focusing comments on regulations that clarify rather than modify and otherwise supplement, or supplant the statutory directives that Congress set forth in 1400Z-2.

With that in mind, I'd like to address my questions and comment to the juxtaposition of the proposed regulations, anti-abuse rule with provision in Section 1400Z-2, Z3A. The bias terms defines a range of business activities the Qualified Opportunity Zone business can engage in, but not those of the qualified opportunity fund engages in certain businesses directly. For example, at a golf course, or a hot tub facility, a country club, or a liquor store or something of that nature.

Now, I think today that difference, the difference between the Qualified Opportunity Zones businesses and the statutory restrictions on the type of "SIN" businesses that it's allowed to engage in. And the fact that there's no statutory restriction on qualified opportunity funds has been referred to as a loophole of some sort.

But, you know, it's only one of many, many differences between the rules that apply to Qualified Opportunity Zone businesses, including substantially all requirements or the amount of property advance, the whole — which Treasury and the IRS are deploying; 70 percent plus 90 percent requirement that qualified opportunity funds would have to, you know, have if they invested directly in the Qualified Opportunity Zone.

And so there is this difference in the statute, and it seems to be reflected — unless I'm mistaken — in the proposed regulations, which restrict the SIN business rules under 144(c)(6)(b), to the part of the regulations that deals with Qualified Opportunity Zone businesses.

However, a number of hotel chains, resorts, and obviously, you know, taxpayers who would otherwise engage in one of the enumerated types of businesses are concerned that the anti abuse provision could be used even though there's no restriction in the statute of regulations against what would seem to be a fairly straightforward application, where qualified opportunity fund engages directly in, for example, the management of the golf course.

And so, you know, the question is whether you consider it abusive for an opportunity fund to engage directly in the acquisition, maybe substantial improvement or development of a new — let's just keep it with golf course — whether that could be Qualified Opportunity Zone property in the hands of that, or Qualified Opportunity Fund.

And sort of as an ancillary issue which sort of applies just to the Qualified Opportunity Zone business, whether you would consider applying a rule similar to the one in Notice 2006-67 for Qualified Opportunity Zones where there's a 10 percent — where there's a 10 percent prohibitive, you know, business safe harbor whereby your gross receipts are under 10 percent, you wouldn't have to — you know, you wouldn't be disqualified.

So, for example, you know, a physical therapist that also engages in massages, you know, or a rehabilitation center, or something of that nature. So those are the three questions.

MS HANLON-BOLTON: Any questions? I mean, we appreciate your comments. I would suggest writing them in a comment letter to us.

SPEAKER: Then I think the New York State Bar Association has —

MS HANLON-BOLTON: Yeah, but I could — the SIN business question has been brought to me a number of times, so it's something that we're actively thinking of.

SPEAKER: And would you consider including example in the anti-abuse regulations one way or the other?

MS HANLON-BOLTON: We will definitely think about it.

SPEAKER: Thank you.

MS HANLON-BOLTON: Yeah. OK. Anybody — MR. NOVEY: As a matter of reg drafting, examples are nice but if there's a clean rule that we could articulate, that would be better. Yeah.

SPEAKER: Or, I think that's worth the 10 percent derivative — derivative business rule and in the, you know, the Notice 2006-67 is useful.

MS HANLON-BOLTON: Was that part of the New York Bar comments?

SPEAKER: No. No. I'll write it up separately in an article.

MS HANLON-BOLTON: OK. All right, thank you. Anybody else? All right then, on behalf of the Panel, we thank you very much for all your comments and suggestions.

And this concludes the Hearing for Investing in Opportunity Zone Funds, Reg Number 120186-18. Thank you.

(Applause)

(Whereupon, at 4:06 p.m., the PROCEEDINGS were adjourned.)