



October 31, 2019

Office of Associate Chief Counsel (Income Tax and Accounting)  
Attention: Erika C. Reigle and Kyle C. Griffin  
Internal Revenue Service (IRS)  
1111 Constitution Avenue, NW  
Washington, D.C. 20224

CC:PA:LPD:PR  
(REG-120186-18)  
Room 5203  
Internal Revenue Service  
P.O. Box 7604  
Ben Franklin Station  
Washington, D.C. 20044

**Re: Supplemental Comments on Related Party Fees (Comments on REG-120186-18: Investing in Qualified Opportunity Funds (Guidance Under §1400Z-2))**

Dear Ms. Reigle and Mr. Griffin:

In our letter dated July 1, 2019, the Novogradac Opportunity Zones Working Group provided comments in response to the second tranche of proposed treasury regulations released April 18, 2019 (the Regulations). This letter is intended to provide further commentary to our request that reasonable capitalized fees paid to a related party with respect to a development or redevelopment of tangible property, (1) are considered an addition to adjusted basis for purposes of measuring the substantial improvement of property, (2) do not cause the property to fail to qualify as qualified opportunity zone property ("QOZBP"), and (3) qualify as QOZBP to the extent the tangible property the fees are paid "with respect to" is QOZBP.

In addition to the qualification of reasonable related party fees, it is common, perhaps typical, in real estate development for an affiliate of the owner of a real estate project to be the general contractor for that project. Payments by a project owner to an affiliated general contractor are primarily used by the general contractor to pay unrelated subcontractors for property and services provided to the general contractor for the benefit of the project owner. A portion of the payments are also retained by the general contractor for reasonable profit, overhead and general requirements of the general contractor. An affiliated general contractor will often be related to the project owner within the meaning of Section 179(d)(2) as modified by Section 1400Z-2(e)(2). Accordingly, investments in a substantial number of real estate assets, including affordable rental housing, are at risk of not satisfying the Section 179(d)(2) purchase requirement and therefore not qualifying as qualified opportunity zone business property.

We recommend that Treasury provide that payments made to a general contractor that is a related party to the project owner that results in additions to basis of tangible property not be treated as failing

the purchase requirements under Section 179(d)(2), provided any amounts retained by the related party contractor for profit, overhead and general requirements under the construction contract are reasonable.

Suggested line edits (New Language):

Add the following subparagraph (G) to Prop. Reg. Sec. 1400Z2(d)-1(c)(4):

**(G) Exception for Reasonable Related Party Expenditures. For purposes of Paragraph (d)(1)(c)(4)(A), reasonable expenditures paid by a QOF to a related party for services that are properly includable in computing the basis of property under the taxpayer’s method of accounting are not treated as failing the purchase requirements under 179(d)(2) as modified by Section 1400Z-2(e)(2). Payments made by a QOF to a related party contractor are considered reasonable for purposes of this paragraph to the extent the amounts are used by the related party contractor as reimbursement of or for payments to unrelated parties for property and/or services and to the extent amounts retained by the related party contractor would be considered reasonable in a transaction not limited by section 179(d)(2).**

Add the following subparagraph (G) to Prop. Reg. Sec. 1400Z2(d)-1(d)(2)(i):

**(G) Exception for Reasonable Related Party Expenditures. For purposes of Paragraph (d)(1)(d)(2)(i)(A), reasonable expenditures paid by a QOZB to a related party for services that are properly includable in computing the basis of property under the taxpayer’s method of accounting are not treated as failing the purchase requirements under 179(d)(2), as modified by Section 1400Z-2(e)(2). Payments made by a QOZB to a related party contractor are considered reasonable for purposes of this paragraph to the extent the amounts are used by the related party contractor as reimbursement of or for payments to unrelated parties for property and/or services and to the extent amounts retained by the related party contractor would be considered reasonable in a transaction not limited by section 179(d)(2).**

We appreciate your consideration of our comments and we are available to discuss at your request.

Yours very truly,

Novogradac & Company LLP



By

Michael J. Novogradac, Managing Partner

Novogradac & Company LLP



By

John S. Sciarretti, Partner

CC: Michael Novey, Office of Tax Policy, Treasury

Julie Hanlon-Bolton, ITA, IRS