



August 19, 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 Letter – Comments on Grace Period for Use of Property (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 (OZ Working Group) provided comments (Comment Letter) in response to the second tranche of proposed treasury regulations released April 18, 2019 (the Regulations). This letter is intended to provide further commentary on our request that qualified opportunity funds (QOFs) and qualified opportunity zone businesses (QOZBs) be permitted a grace period to use tangible property in a trade or business.

The opportunity zones (OZ) statute and Regulations require that tangible property be used in a trade or business of a QOF or QOZB to be considered Qualified Opportunity Zone Business Property (QOZBP).¹ The OZ statute provides stock or a partnership interest, to qualify as QOZP, must be in a corporation or partnership that is a QOZB at the time of acquisition or “such (corporation or partnership) was being organized for purposes of being a qualified opportunity zone business”.² This language acknowledges that a start-up period is anticipated. The Regulations address the use of working capital within a 31-month period but not whether the

¹ IRC Sec. 1400Z-2(d)(2)(D)(i), Prop. Reg. Sec. 1.1400Z2(d)-1(c)(4), and Prop. Reg. Sec. 1.1400Z2(d)-1(d)(2).

² IRC Sec. 1400Z-2(d)(2)(B)(i)(III) and (C)(ii).

QOZB must also use its tangible property in a trade or business during that 31-month period or any other period. The second tranche of Regulations expands the working capital safe harbor to include the development of a trade or business but does not clarify the result if the QOZB is not using the tangible property in a trade or business by the end of the 31-month period. The issue is whether a QOF or QOZB is provided a grace period to use tangible property in a trade or business to qualify as QOZBP. For example, if a QOF or QOZB purchases equipment but the equipment is not put into use in a trade or business immediately because the trade or business is still in the development phase, is the equipment not qualified until it is used in the trade or business? If a QOF or QOZB constructs a building and after 31 months the building is not fully completed and therefore not placed in service, is the building not qualified until it is used in the trade or business?

Furthermore, in the case of substantial improvement of tangible property by a QOF or a QOZB that is not within the safe harbor for property on which working capital is being expended, the Regulations do not clarify whether the pre-existing tangible property is treated as satisfying the requirements during the 30-month substantial improvement period before the basis of the property is doubled.

We recommend that Treasury provide that tangible property of a QOF or a QOZB is not treated as failing to satisfy the use in a trade or business requirement solely because the tangible property is not in use in a trade or business before a reasonable start-up period, based upon facts and circumstances, as long as the QOF or QOZB continues to develop the trade or business, including when appropriate the acquisition, construction, and/or substantial improvement of tangible property, and, in the case of a QOZB, reasonably expects at least 50 percent of the gross income of the trade or business will be derived from the active conduct of a trade or business in the qualified opportunity zone when the trade or business begins.

Alternatively, we recommend that Treasury provide a 12-month grace period for a QOF or QOZB to use tangible property in a trade or business, with such grace period beginning no earlier than the end of a 31-month period to acquire, construct and/or improve tangible property or develop a trade or business. As an additional alternative, Treasury could provide that the activity of developing a QOZB is a trade or business, such that tangible property held during the development of a trade or business is considered used in a trade or business before the trade or business begins.

We also recommend that pre-existing tangible property required to be substantially improved by a QOF or QOZB that is not within the safe harbor for property on which working capital is being expended is not treated as failing to satisfy the substantial improvement requirement during the 30-month improvement period before its basis is doubled.

We recommend the following line edits to Prop. Reg. Sec. 1.1400Z2(d)-1(c)(4)(i)(D):

In the case of tangible property that is owned or leased by the QOF, during substantially all of the QOF's holding period for the tangible property, substantially all of the use of the tangible property was in a qualified opportunity zone. **Tangible property is not treated as failing to satisfy the requirements of this section (c)(4)(i)(D) and is not treated as failing to satisfy the requirement to originally use such property in a qualified opportunity zone solely because the tangible property is not used in a trade or business before a reasonable start-up period, based upon facts and circumstances, as long as the QOF continues to develop the trade or business in a qualified opportunity zone, including when appropriate the acquisition, construction, and/or substantial improvement of tangible property.**

We recommend the following line edits to Prop. Reg. Sec. 1.1400Z2(d)-1(d)(2)(i)(D):

In the case of tangible property that is owned or leased by the entity during substantially all of the entity's holding period for the tangible property, substantially all of the use of the tangible property was in a qualified opportunity zone. **Tangible property is not treated as failing to satisfy the requirements of this section (d)(2)(i)(D) and is not treated as failing to satisfy the requirement to originally use such property in a qualified opportunity zone solely because the tangible property is not yet used in a trade or business before a reasonable start-up period, based upon facts and circumstances, as long as the QOZB continues to develop the trade or business in a qualified opportunity zone, including when appropriate the acquisition, construction, and/or substantial improvement of tangible property and the taxpayer reasonably expects at least 50 percent of the gross income of the trade or business will be derived from the active conduct of a trade or business in the qualified opportunity zone when the trade or business begins.**

We recommend the following line edits to Prop. Reg. Sec. 1.1400Z2(d)-1(d)(5)(vii):

Safe harbor for property on which working capital is being expended. If paragraph (d)(5)(iv) of this section treats some financial property as being a reasonable amount of working capital because of compliance with the three requirements of paragraph (d)(5)(iv)(A)-(C) and if the tangible property referred to in paragraph (d)(5)(iv)(A) is expected to satisfy the requirements of section 1400Z2(d)(2)(D)(1) as a result of the planned expenditure of those working capital assets, then that **financial property, and any tangible property obtained with such financial property** is not treated as failing to satisfy those requirements

~~solely~~ because the scheduled consumption of the working capital is not yet complete and, once the scheduled consumption of working capital is complete, because the tangible property is not used in a trade or business before a reasonable start-up period, based upon facts and circumstances, as long as the QOZB continues to develop the trade or business in a qualified opportunity zone, including when appropriate the acquisition, construction, and/or substantial improvement of tangible property and the taxpayer reasonably expects at least 50 percent of the gross income of the trade or business will be derived from the active conduct of a trade or business in the qualified opportunity zone when the trade or business begins.

We recommend the following line edits to Prop. Reg. Sec. 1.1400Z2(d)-1(d)(5)(ii):

In general. Section 1400Z-2(d)(3) incorporates section 1397C(b)(4), requiring that, with respect to any taxable year, a substantial portion of the intangible property of an opportunity zone business is used in the active conduct of a trade or business in the qualified opportunity zone. For purposes of section 1400Z-2(d)(3)(ii) and the preceding sentence, the term substantial portion means at least 40 percent. ~~Intangible property is not treated as failing to satisfy the requirements of this section (d)(5)(ii) solely because the intangible property is not used in a trade or business before a reasonable start-up period, based upon facts and circumstances, as long as the QOZB continues to develop the trade or business in a qualified opportunity zone.~~

We recommend you add the following subparagraph (iii) to Prop. Reg. Sec. 1.1400Z2(d)-1(c)(8):

~~(iii) Safe harbor for property which is undergoing substantial improvement. Property undergoing substantial improvement is not treated as failing to satisfy the substantial improvement requirements of paragraph (c)(4)(i)(6) of this section during any 30-month period before the additions to the basis of the property in the hands of the QOF exceed an amount equal to the adjusted basis of the property at the beginning of the 30-month period in the hands of the QOF as long as the QOF is making continuous efforts to substantially improve the property and substantially improves the property within 30 months.~~

We recommend you add the following subparagraph (iii) to Prop. Reg. Sec. 1.1400Z2(d)-1(d)(4):

~~(iii) Safe harbor for property which is undergoing substantial improvement. Property undergoing substantial improvement is not treated as failing to satisfy the substantial improvement requirements of paragraph (d)(2)(i)(C) of this section during any 30-month period before the additions to the basis of the~~

property in the hands of the qualified opportunity zone business exceed an amount equal to the adjusted basis of the property at the beginning of the 30-month period in the hands of the qualified opportunity zone business as long as the qualified opportunity zone business is making continuous efforts to substantially improve the property and substantially improves the property within 30 months.

We appreciate your consideration of these comments and we are available to provide any additional insight and background regarding our comments you may desire.

Yours very truly,

Novogradac & Company LLP



By

Michael J. Novogradac, Managing Partner

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By

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CC: Michael Novey, Office of Tax Policy, Treasury

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