

## VIA ELECTRONIC MAIL

December 28, 2018

Internal Revenue Service  
1111 Constitution Avenue, N.W.  
Washington, DC 20224

RE: Comments on Proposed Regulations under Section 1400Z-2 of the Internal Revenue Code;  
IRS REG-115420-18

Dear Sir or Madam:

On behalf of its member banks, the American Bankers Association (ABA)<sup>1</sup> is pleased to submit the following comments related to the operation of the Opportunity Zone tax incentive included in the Tax Cuts and Jobs Act of 2017 (TCJA). Banks care about the vibrancy and vitality of their communities and support the goals associated with Opportunity Zones. Banks operate in these communities and supply financial products and services that provide important economic opportunities for individuals, families, small business owners and other customers.

Given that this is a new statute, there are a wide variety of operational and other types of issues that are being considered. That said, our members have asked us to present three specific topics that are discussed below.

### **The Definition of “Taxpayer” Should Include All Members of a Consolidated Group**

Section 1400Z-2(a) indicates that a “taxpayer” may make investments in qualified opportunity funds and, assuming certain requirements are met, receive the benefits outlined in Sections 1400Z-2(b) and 1400Z-2(c). Proposed regulation 1.1400Z-2(a)-1(b)(1) includes a definition for an “eligible taxpayer”. The definition is broad and simply says:

“An eligible taxpayer is a person that may recognize gains for purposes of Federal income tax accounting. Thus, eligible taxpayers include individuals; C corporations, including regulated investment companies (RICs) and real estate investment trusts (REITs); partnerships; S corporations; trust and estates.”

We believe that the final regulations should clarify that an eligible taxpayer includes all members of a consolidated group (i.e., an affiliated group of corporations (as defined under Section 1504) that files a consolidated return under Section 1501) as a single taxpayer when any member recognizes a qualified gain and would have otherwise reported the qualified gain on the tax return for the consolidated group. Most corporate taxpayers file a tax return as a consolidated group that includes separate legal entities for various business or regulatory reasons. In our industry, there can be different applicable regulatory rules

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<sup>1</sup> The American Bankers Association is the voice of the nation’s \$1 trillion banking industry, which is comprised of small, regional, and large banks that together employ more than 2 million people, safeguard \$13 trillion in deposits, and extend more than \$9 trillion in loans.

that drive which member of the consolidated group can make a particular type of investment. For example, a bank, which is a subsidiary of a holding company that is the parent of the consolidated group, may sell an asset that generates a qualified gain. The consolidated group wishes to make an opportunity zone investment. However, the ability to make such an investment may be limited to a sister subsidiary within the consolidated group that is subject to different regulatory powers with regard to these types of permissible investments. Accordingly, to participate in a qualified opportunity fund investment, the investment would need to be made in the separate sister subsidiary that has the appropriate regulatory authority.

While bank regulatory rules (as referenced in the example above) are obviously uniquely applicable to financial institutions, this consideration is nevertheless not banking specific in that most taxpayers have designed their legal entity structures for appropriate business reasons applicable to their operations.

Additionally, although focused on a different section of the Internal Revenue Code, a similar consolidated approach is incorporated in the proposed regulations under Section 163(j). See Proposed Regulation 1.163(j)-4(d)(2).

We believe that the use of the consolidated group as an eligible taxpayer for purposes of applying the opportunity zone provisions is the correct approach as it should enhance the ability of taxpayers to participate in the program and therefore enhance its success without contradicting the intent of the program.

We recognize that there may be a need for related adjustments to the consolidated return regulations to properly attribute income to individual members of the consolidated group given that opportunity zone investments may impact the timing and amount of gain recognition. There are examples in the existing regulations (such as Section 267) that match recognition events between members with the timing of gain or loss recognition in the consolidated group.

Finally, if a qualified opportunity fund is a member of the consolidated group, we recognize that gains in the fund would not generate additional “capacity” for the consolidated group to make opportunity fund investments.

### **The Timing of Qualified Opportunity Fund Investments Requires Flexibility**

Section 1400Z-2(d) contains requirements for a qualified opportunity fund and states:

“The term “qualified opportunity fund” means any investment vehicle which is organized as a corporation or a partnership for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund) that holds at least 90 percent of its assets in qualified opportunity zone property, determined by the average of the percentage of qualified opportunity zone property held in the fund as measured –

- (A) on the last day of the first 6-month period of the taxable year of the fund, and
- (B) on the last day of the taxable year of the fund.”

Our members believe that the timing of the testing dates in this requirement is problematic. The preamble to the proposed regulations acknowledges that other commenters have identified this issue as an important concern and an impediment to investing in qualified opportunity zones.

We acknowledge that the proposed regulations attempt to address this concern by including a working capital safe harbor at the qualified opportunity zone business level. We appreciate the important language included in Proposed Regulation 1.1400Z-2(d)-1(d)(5)(iv):

“Safe harbor for reasonable amount of working capital. Solely for purposes of applying section 1397C(e)(1) to the definition of a qualified opportunity zone business under section 1400Z-2(d)(3), working capital assets are treated as reasonable in amount for purposes of section 1397C(b)(2) and 1400Z-2(d)(3)(A)(ii), if all of the following three requirements are satisfied:

Designated in writing. These amounts are designated in writing for the acquisition, construction and/or substantial improvement of tangible property in a qualified opportunity zone, as defined in section 1400Z-1(a).

Reasonable written schedule. There is a written schedule consistent with the ordinary start-up of a trade or business for the expenditure of the working capital assets. Under the schedule, the working capital assets must be spent within 31 months of the receipt by the business of the assets.

Property consumption consistent. The working capital assets are actually used in a manner that is substantially consistent with paragraph (d)(5)(iv)(A) and (B) of this section.”

We believe this important safe harbor should be applied at a combined qualified opportunity fund and qualified opportunity zone business level. This change should be helpful in addressing the following concerns:

- There will often be time lags between when qualified gains are recognized and the identification of qualified opportunity zone properties. The combination of the 180-day investment period required at the taxpayer level and the 6 month (at most) testing date period at the qualified opportunity fund level for investing in qualified opportunity zone property is simply too short a period of time. Maintaining these requirements will likely diminish the amount of qualified gains that can reasonably be invested in the opportunity zones.
- Once a qualified opportunity zone property is identified, there are a variety of important business reasons that may necessitate that capital (and cash) be deployed in the business over a period of time. These business reasons could include managing contractual obligations with various business partners / vendors, etc., managing financing obligations, managing credit risk and on an overall basis, improving the financial performance of the project. By allowing a broader safe harbor application, this should, in turn, enhance the success of the opportunity zone program.

We believe our suggested change could be made in the context of the approach found in the statute, specifically in Section 1400Z – 2(e)(4)(B). Although this section refers to reinvestment of gains recognized by a qualified opportunity fund, it recognizes the challenges in this area. The statute includes direction to the Secretary to prescribe:

“rules to ensure a qualified opportunity fund has a reasonable period of time to reinvest the return of capital from investments in qualified opportunity zone stock and qualified opportunity zone partnership interests, and to reinvest proceeds received from the sale or disposition of qualified opportunity zone property, .....”

We suggest that Treasury consider adding a section in the operation of the 90 percent test that recognizes qualified opportunity zone property may not be available or identified at the end of the maximum 6 month testing period. This section would require the qualified opportunity fund to prepare documentation under penalties of perjury that follow requirements similar to those for working capital as set forth in Proposed Regulation 1.1400Z-2(d)-1(d)(5)(iv). If a higher level of documentation and scrutiny is needed at the fund level, specific documentation could be required as part of the qualified opportunity fund tax return filing.

Assuming the rules are available and applied across both the qualified opportunity fund and qualified opportunity zone business levels, we do not believe this exception will ultimately result in a delay in the deployment of funds to opportunity zones. We are not suggesting that there should be an overall delay in an investment meeting the requirements. An example may be helpful.

For example, assume a taxpayer recognizes a qualified gain. The taxpayer has a desire to build or invest in a particular census tract that has been identified as a qualified opportunity zone. The taxpayer establishes a qualified opportunity fund entity and concurrently searches for qualified opportunity zone properties or projects within the qualified opportunity zone. At the end of the taxpayer's 180-day period, an appropriate property or project has not yet been identified. Nonetheless, the taxpayer invests the gain in the fund. The fund continues to search for a qualified property, but at the first testing date there is not yet a firm commitment to a specific project; however, it is apparent that there will be an acceptable, firm prospect in the coming months.

Even in situations in which a property or project is identified, it may be challenging to establish the appropriate opportunity zone business entity or structure to meet the timing requirements. In addition, the existence of the safe harbor exclusively at the qualified opportunity zone business level may require the qualified opportunity fund to pre-fund projects, which is generally not a normal or prudent business practice.

Under our recommended approach, the fund would prepare the required documentation using the working capital safe harbor requirements, although the specific project details may not be available. The qualified opportunity fund and qualified opportunity zone business will have 31 months combined from the time a qualified gain is contributed into a qualified opportunity fund to have a qualified opportunity zone property identified and operating in accordance with the various definitions. During this 31 month period, the opportunity fund entity will be required to include such documentation in its tax return during the period it utilizes the safe harbor.

We believe a broadening of the safe harbor allows for greater flexibility for deployment of qualified gains via the opportunity fund, provides a means for better pairing of qualified gains with qualified projects, maintains the commitment of the taxpayer with the qualified gain, provides for compliance guardrails with enhanced documentation requirements and ultimately has the project operational in the same time frame as it would have been had the safe harbor only applied to the qualified opportunity zone business itself as described in the proposed regulations. Therefore, we urge Treasury to consider adding this favorable flexibility that will benefit both opportunity zones and qualified taxpayers.

### **Identification Period for Capital Gains Allocated from Pass-through Entities Should Be Modified**

Many banks and other taxpayers have significant investments in a large number of partnerships and other types of pass-through entities. These partnerships may recognize qualified gains and the allocable share of those gains are reported to the partners /owners of the pass-through entity annually on Schedule K-1.

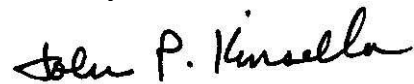
The proposed regulations provide welcome rules regarding situations in which the pass-through entity does not elect to invest qualified gains in opportunity zones and give individual partners/owners an ability to elect to invest their distributive shares. Under the proposed regulations, the 180-day period for making a qualified investment in an opportunity zone begins on the last day of the pass-through entity's taxable year.

Since it is common that the required calculations and related gain information are generally not available to the owner of the pass-through entity until the tax return and related Schedule K-1's are completed, in most cases, using the time frame in the proposed regulations, the owner of the pass-through entity may lose part or all of the 180-day period since the requisite information is not readily available to them.

While we acknowledge that obtaining appropriate estimates of tax information from pass-through entities and their advisors on a timely basis may be possible, this is challenging, especially for entities with hundreds of investments in pass-through entities. To provide some flexibility, we suggest that the beginning of the 180-day time period for investment into a qualified opportunity fund be tied to the original due date of pass-through entities' tax returns. For partnerships and S corporations, this will be two and one-half months after the end of the pass-through entity's taxable year. Again, we hope this will facilitate more investment in qualified opportunity zones by removing an obstacle that exists for investors in numerous pass-through entities.

We appreciate this opportunity to comment on the proposed regulations. Please do not hesitate to contact us with any questions or if we can provide additional information.

Sincerely,

A handwritten signature in black ink that reads "John P. Kinsella". The signature is written in a cursive, flowing style.

John P. Kinsella