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RE: REG-120186-18
Response to Solicitation for Written Public Comment
Proposed Regulations Pursuant to 26 U.S.C. sec. 1400Z-2

To Whom It May Concern:

This written comment is provided in response to 84 F.R. 18652-18693 (May 1, 2019) in which the Department of Treasury and the Internal Revenue Service are seeking, *inter alia*, public comment on:

(1) The proposed definition of the "original use" requirement in 26 U.S.C. sec. 1400Z-2(d)(2);

(2) The "circumstances under which tangible property that had not been purchased but has been overwhelmingly improved by a [qualified opportunity fund] or a qualified opportunity zone business may be considered as satisfying the original use requirement. . . ." 84 F.R. 18655; and

(3) "Other issues that should be addressed to further clarify the rules under section 1400Z-2, as well as comments on all aspects of the proposed regulations," (84 F.R. 18652) which would include the determination of basis on investments held on qualified opportunity zone property.

By way of background, this firm serves as special redevelopment counsel for several public entities in New Jersey in which there is an overlap of a qualified opportunity zone with properties that have been designated as areas in need of redevelopment and/or as areas in need of rehabilitation pursuant to the Local Redevelopment and Housing Law, N.J.S.A. 40A:12A-1 et seq. (the "LRHL"). These entities include the City of Newark; the Township of Neptune; the Perth Amboy Redevelopment Agency; the Borough of Flemington; the Township of Carneys Point; and the City of Salem. The LRHL is a comprehensive New Jersey statute that empowers and assists local governments in their efforts to arrest and reverse "conditions of deterioration in housing, commercial and industrial installations, public services and facilities and other physical components and supports of community life, and improper, or lack of proper, development which result from forces which are amenable to correction and amelioration by concerted effort of responsible public bodies, and without this public effort are not likely to be corrected or ameliorated by private effort." N.J.S.A. 40A:12A-2(a). Additionally, the LRHL promotes "the advancement of community interests through programs of redevelopment, rehabilitation and incentives to the expansion and improvement of commercial, industrial, residential and civic facilities." N.J.S.A. 40A:12A-2(b).

Importantly, redevelopment often includes and requires the demolition of existing buildings and clearing of property within areas designated in need of redevelopment pursuant to the LRHL in order to revitalize the area with the construction of new residential and commercial uses. Presently, the proposed regulations and 26 U.S.C. sec. 1400Z-2 divide the definition of "qualified opportunity zone business property" into either: (1) substantially improving an existing building(s) within thirty (30) months from the date of the acquisition of the property in a qualified opportunity zone; or (2) construction from the ground-up if it is considered "original use" of the property. Additionally, while the definition of "substantially improves" requires the expenditure of capital from the qualified opportunity fund to at least equal the basis of an existing building within the tight timeframe of thirty (30) months from the date of acquisition of real property, there is not such a statutorily required time constraint for construction from the ground-up, if it is considered original use.

After considering prior comments regarding the definition of "original use" the proposed regulation provides:

> *Original use of tangible property acquired by purchase* – (i) *In general.* For purposes of paragraph (c)(4)(i)(C) of this section, the original use of tangible property in a qualified opportunity zone commences on the date any person first places the property in service in the qualified opportunity zone for purposes of depreciation or amortization (or first uses it in a manner that would allow depreciation or amortization if that person were the property's owner). <u>For purposes of this paragraph (c)(7), if property has been unused or vacant for an uninterrupted period of at least 5 years, original use in the qualified opportunity zone commences on the date after that period when any person first so uses or</u>

> places the property in service in the qualified opportunity zone. Used tangible property satisfies the original use requirement if the property has not been previously so used or placed in service in the qualified opportunity zone. If the tangible property had been so used or placed in service in the qualified opportunity zone before it is acquired by purchase, it must be substantially improved in order to satisfy the requirements of section 1400Z-2(d)(2)(D)(i)(II).

Sec. 1.1400Z2(d)-1(c)(7) (emphasis added).

In order to define "original use" so that it can become a catalyst to further spur revitalization, five (5) years is too long a time period for property to have been unused or vacant to qualify as original use. While during the public hearing held on February 14, 2019 there were many commentators suggesting one (1) year, the IRS is concerned about intentional acts of property owners to increase marketability of their property. ("Given the different operation of those provisions and the potential for owners of property already situated in a qualified opportunity zone to intentionally cease occupying property for 12 months in order to increase its marketability to potential purchases after 2017, other commentators proposed longer vacancy thresholds ranging to five years.") (84 F.R. 18654). We recommend a shorter time period so as not to artificially exclude properties from the definition of "original use" that would greatly benefit under the qualified opportunity zone program for more comprehensive redevelopment and/or revitalization and that would otherwise take more than the thirty (30) months to "substantially improve" a single building. In light of the fact that the IRS has rejected one (1) year, and without automatically moving to the uppermost range of any prior written comment, we recommend two (2) years as the uninterrupted period for nonuse or vacancy of property in order for such property to qualify as original use.

Additionally, this commentator supports tangible property that had not been purchased but has been "overwhelmingly improved" by a qualified opportunity fund or a qualified opportunity zone business to be considered as satisfying the original use requirement. The absence of a purchase requirement would, for example, imply a ground lease of the property and require contractual provisions between the qualified opportunity fund and the property owner giving control to the qualified opportunity fund over the sale of the investment and the gain realized. This may provide greater flexibility in the context of comprehensive redevelopment situated in a qualified opportunity zone. A definition of "overwhelmingly improved" would need to be provided. This could, for example, include construction from the ground-up and/or the demolition, revitalization and construction of new buildings that at least triples the basis of the property in the hands of the qualified opportunity fund.

Finally, 26 U.S.C. sec. 1400Z-2(b)(2)(B) entitled "Determination of Basis" does not statutorily require the capital gain invested in qualified opportunity zone property to occur by December 31, 2019 in order for the taxpayer to receive a fifteen percent (15%) increase in basis to the capital gain invested. The statute provides:

> In the case of any investment held by the taxpayer for at least 7 years, in addition to any adjustment made under clause (iii),[1] the basis of such property shall be increased by an amount equal to 5 percent of the amount of gain deferred by reason of subsection (a)(1)(A).

26 U.S.C. sec. 1400Z-2(b)(2)(B)(iv).

In light of the fact that the special rule for investments held for ten (10) years is proposed to expire in 2047, provided that the investment in qualified opportunity zone property occurred prior to the close of the tenth year after the qualified opportunity zone was designated, the same logic should apply to the increase in basis on the initial capital gain invested. In other words, so long as the investment in qualified opportunity zone property was held by the taxpayer for at least seven (7) years and provided that the investment occurred prior to the expiration of the qualified opportunity fund zone on the tenth year after the qualified opportunity zone was designated, the taxpayer should receive the fifteen percent (15%) increase in basis in accordance with the statute. Similarly, investments held for five (5) years should receive an increase in the basis by ten percent (10%) provided that the investment occurred prior to the date that the qualified opportunity zone expires.

Unlike the statutory requirement set forth at 26 U.S.C. sec. 1400Z-2(b)(1) which provides that that the deferral of gain invested in opportunity zone expires on the earlier of "the date on which such investment is sold or exchanged, or December 31, 2026" no such statutorily mandated date was provided with respect to the "Determination of Basis" section set forth at 26 U.S.C. sec. 1400Z-2(b)(2)(B). Therefore, in order to give the statute its plain meaning, regulations promulgated by the Department of Treasury and the IRS to effectuate the provisions of the statute should not limit the deadlines in which the investment in qualified opportunity zone property may be made in order for the taxpayer to receive the increase in basis as envisioned by the statute. It is respectfully submitted that providing for such flexibility will further encourage the goals of the qualified opportunity zone program.

Thank you for your consideration of this written public comment and I look forward to the public hearing scheduled for July 9, 2019.

Very truly yours,

Brent Carney

[1] Clause (iii) provides "in the case of any investment held for at least 5 years, the basis of such investment shall be increased by an amount equal to 10 percent of the amount of gain deferred by reason of subsection (a)(1)(A)." 26 U.S.C. 1400Z-2(b)(2)(B)(iii).