

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

June 28, 2019

To Whom It May Concern:

Thank you for this opportunity to respond to the Notice of Proposed Rulemaking, Investing in Qualified Opportunity Funds, issued May 1, 2019 (“NPRM”). It is encouraging to see this topic receive such a high level of attention and careful diligence from the staff at the Department of the Treasury (“Treasury”) and the Internal Revenue Service (“IRS”).

The U.S. Impact Investing Alliance and our members represent collectively over 1,000 investors and financial intermediaries who are actively engaged in deploying private capital to advance the public good. We believe that it is possible to leverage 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 stakeholders have particularly deep knowledge of and experience investing for community economic development. They include institutional investors, foundations, high net worth families, banks and Community Development Financial Institutions (“CDFIs”) that understand the importance of place, local context and authentic community engagement when investing in low-income communities. For this reason, we have taken a keen interest in Opportunity Zones (“OZs”), Opportunity Funds and the development of pertinent regulations. It is based on consultation with our members that we offer the following comments.

Under separate cover, we have requested the opportunity to testify on the matters discussed below at the public hearing currently scheduled for July 9, 2109.

#### **General Comments on Regulatory Clarity and Market Transparency**

The goal of the OZ tax benefit and Section 1400Z of the Internal Revenue Code (“the Statute”), as stated in the previously released proposed regulations, is clear: “to encourage economic growth and investment in designated distressed communities.”<sup>1</sup> The policy looks to achieve this goal by creating conditions for a new market for community investments to form. An efficient market can then direct capital towards projects and enterprises that will generate the desired economic opportunities for those living and working in OZs. To that end, certain market structures – including appropriate regulation – will be necessary to enable capital to flow efficiently, both from investors to funds and from funds to investees in OZs.

The NPRM and previous proposed rulemakings have made significant progress towards enabling the formation of a market for investment in Qualified Opportunity Funds (“QOFs”). Sound regulation is the backbone of efficient markets, ensuring investor confidence in the financial products offered to them. In

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<sup>1</sup> 83 FR 54279 <https://www.federalregister.gov/d/2018-23382/p-8>.

the case of OZs, it is all the more important to provide investor assurances because, by their nature, OZs are communities in which many private investors lack experience doing business. As such, we urge Treasury and the IRS to address the outstanding issues detailed in our comments below.

### **Adoption of Consistent Reporting Standards**

We were glad to see Treasury issue a “Request for Information (“RFI”) on Data Collection and Tracking for Qualified Opportunity Zones,” and we offered comments in response.<sup>2</sup> This topic is one of the single most important issues as yet unresolved with respect to OZ implementation.

The OZ market cannot function efficiently without access to basic, transparent data about QOFs and their investments. For this reason, we recommend that Treasury collect and publicly report on basic, transaction-level data about QOF 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.<sup>3</sup>

Such reporting should be done in a manner other than through a tax form, and the information should be made available to the public in a disaggregated and timely manner. Such reporting would not create any meaningful burden on QOF managers, and the public benefit of such reporting was articulated in a wide range of public comments submitted in response to the RFI.

The statutory language creating Opportunity Zones gives Treasury the necessary authority to collect and report basic transaction data. Collection of this data will enable QOF managers to track and certify their compliance with 1400Z-2(d)(1), and the Secretary is given the specific authority to promulgate regulations that facilitate the certification of QOFs under (e)(4)(A).

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 rules to prevent abuse, as envisioned in (e)(4)(C). We will explore some instances of this in subsequent portions of this comment.

Finally, as discussed above, Treasury has clearly articulated that the purpose of the Statute is to promote economic activity in OZs. This intent is further supported by the statutory language and legislative history of 1400Z. To the extent that 1400Z-2 is intended to further that goal through the creation of specific tax benefits, and to the extent that those benefits are made more attractive to investors by the collection and reporting of basic transaction data (as discussed in our previous comments), the Department has the broad authority to promulgate regulations that enable this reporting under (e)(4).<sup>4</sup>

Such a reporting process as envisioned above would require a minimum level of staffing within Treasury to implement reporting, ensure completeness and accuracy of data, and prepare reports. The CDFI Fund

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<sup>2</sup> TREAS-DO-2019-0004-0045 <https://www.regulations.gov/document?D=TREAS-DO-2019-0004-0045>.

<sup>3</sup> Our comments in response to the Treasury RFI on Data Tracking and Reporting, cited above in (2), and previously submitted in response to the first NPRM, cited below in (8), detail these benefits specifically.

<sup>4</sup> The language of the conference report, the legislative history of the Statute, and both contemporary and subsequent commentary from the Statute’s principal sponsors all further suggest that Congress viewed the collection and reporting of certain information about the activity of Opportunity Funds and the subsequent effects on OZs as important components of the overall policy. That the Statute gives the Secretary broad rather than narrow authority to design this reporting scheme should be taken as further encouragement to consider the needs of market participants (investors, fund managers, local policymakers, and OZ residents) in this process.

provides a model in its role implementing and overseeing the New Markets Tax Credit (“NMTC”) program, and we suggest that the Secretary consider leveraging this existing resource to support OZ implementation.

### **General Anti-Abuse Rule**

It is important and encouraging that the NPRM provides the IRS Commissioner with the appropriate authority to recharacterize abusive investments as non-qualifying. However, as other commenters have mentioned, Treasury should provide investors with greater clarity over the specific circumstances in which it may be applied.

Our comments will discuss some of the specific scenarios that we believe could be enumerated as conditions upon which the general rule could be applied. Still, it should be underscored that the complexity of understanding this policy as it is implemented in real time leaves open the possibility of serious abusive acts or unintended consequences down the line. As such, it is important that Treasury and the IRS maintain the necessary flexibility to ensure that the Statute continues to be implemented in a manner that is faithful to its letter and intent.

One approach to consider with the dual goals of providing investor assurances and at the same time promoting a high standard of conduct by QOF managers would be the adoption of a safe harbor tied to an independent verification or standard. For instance, QOFs could be independently audited and certified by a third party as conforming with high standards of community engagement.

Independent standards used to certify or otherwise comply with Benefit Corporation status provide one applicable model. Having been adopted as a legal corporate form in at least 33 states and the District of Columbia, Benefit Corporations are generally required to comply with standards set by an independent body which can include certification of compliance. Benefit Corporations are generally required to report annually on impact to their shareholders and the public, and the legal form creates enforceable accountability to meet their public benefit commitments. In return, Benefit Corporations can become eligible for favorable tax status and other benefits.<sup>5</sup>

At the Federal level, the Small Business Administration’s (“SBA”) Impact Fund program provided an example of third-party certification. The program assigned various benefits to “Impact Small Business Investment Corporations” in part based on the completion of an annual third-party impact assessment.<sup>6</sup> The SBA designated multiple such privately administered assessment tools and left open the possibility that private actors could develop additional standards in the future. Thus, in such a program, there is room for market innovation to develop standards that meet the needs of communities, policymakers, fund managers and investors alike.

Though the process of QOF certification would be handled by the private sector in this model, there would be a need for some degree of administration by Treasury. We recommend that the CDFI Fund has the appropriate expertise to administer the designation of suitable third-party and independent certifications and should be delegated the task of identifying suitable certifications under this safe harbor.

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<sup>5</sup> <https://benefitcorp.net/policymakers>.

<sup>6</sup> [https://www.sba.gov/sites/default/files/articles/SBA%20Impact%20Investment%20Fund%20Policy%20-%20September%202014\\_1.pdf](https://www.sba.gov/sites/default/files/articles/SBA%20Impact%20Investment%20Fund%20Policy%20-%20September%202014_1.pdf).

We remain open to other possible approaches to provide investors with some degree of certainty while maintaining appropriate enforcement powers for Treasury and the IRS.

### **Additional Certification of Fund Managers**

In addition to the reporting and anti-abuse requirements described above, it would further benefit investors if fund managers were required to certify that they have not been indicted or convicted of fraud, embezzlement, forgery, theft or other similar offenses in the preceding three years. Treasury could refer to requirements in other programs, such as NMTC, which include similar requirements. Care should be given to ensuring that this requirement does not impede returning citizens from participating equitably in the OZ policy.

### **Land Banking**

The NPRM acknowledges that proposed definitions for original use with respect to land could create the potential for “land banking.”<sup>7</sup> We wish to underscore first, that land banking plainly falls outside of the intention of the Statute and should be actively guarded against. Second, it is important to remember that any land banking inside OZs will produce significant negative externalities, suppressing overall economic activity in the afflicted zone and thereby doing harm to other, non-abusive QOFs and investors therein.

To prevent land banking, Treasury and the IRS should institute clear and consistent reporting standards for transaction-level activity of QOFs. As detailed in our previous comments,<sup>8,9</sup> this level of information is both readily available to QOF managers and necessary for market formation. Transaction-level information will provide the IRS with necessary data to verify that an active trade or business is in fact being conducted on a given parcel of land.

Furthermore, land banking should be specifically enumerated as an abusive practice, and any investments identified as such should be subject to recharacterization according to the general rule to prevent abuse. Over and above the existing protections against the practice, this specific enumeration of land banking as abusive would create a significant incentive for investors to ensure QOF managers maintain compliance.

Finally, this enumeration of land banking should be expansive enough to include certain businesses that create little or no meaningful economic activity inside the OZ, such as self-storage facilities. Such industries are unlikely to substantively advance the goals of the Statute and should not qualify for tax benefits. At the very least, Treasury and the IRS should acknowledge that the IRS Commissioner could deem such business activities as land banking, and as such non-qualifying, after an examination of the facts and circumstances.

### **Sin Businesses**

The Statute clearly seeks to preclude tax incentives for investments in so-called “sin businesses.”<sup>10</sup> It is unclear, however, if those provisions apply to both the operations of Qualifying Opportunity Zone

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<sup>7</sup> 84 FR 18652 <https://www.federalregister.gov/d/2019-08075/p-27>.

<sup>8</sup> IRS-2018-0029-0067 <https://www.regulations.gov/document?D=IRS-2018-0029-0067>.

<sup>9</sup> TREAS-DO-2019-0004-0045 <https://www.regulations.gov/document?D=TREAS-DO-2019-0004-0045>.

<sup>10</sup> 1400Z-2(d)(3)(A)

Businesses (“QOZBs”) and also directly to the QOF, should it be engaged itself in active trade or business. It is further unclear if a QOZB could lease real property to sin businesses.

Any final rule should take the opportunity to clarify that the non-de minimis use of property in any of the excluded activities will prevent such property from being regarded as Qualifying Operating Business Property (“QOZBP”) of a QOF. Further, final regulations should require that a QOZB cannot lease more than a de minimis amount of its property to a “sin business.”

Once again, clear and consistent transaction-level reporting requirements would facilitate the effective enforcement of this prohibition and provide additional confidence to investors that their QOF managers are acting in accordance with their statutory and fiduciary responsibilities.

### **Definitions of “Substantially All”**

In the previous NPRM,<sup>11</sup> Treasury acknowledged that “the compounded use of substantially all must be interpreted in a manner that does not result in a fraction that is too small to implement the intent of congress.” This concern is correct, and we believe that this could produce uncertainty for investors if not thoroughly addressed in the final regulations. We also believe that the current proposed rules could be modified in such a way as to provide clarity to investors and reinforce the integrity of the policy.

Specifically, we believe the definition of “substantially all” as it relates to the tangible property of a QOZB should be set at 90 percent if the QOZB is principally a real estate business. While the greater flexibility of this standard is critically important to ensuring that operating businesses can take advantage of the incentive, there is no statutory justification to allow a significant amount of non-qualifying rental real estate assets to be held by a fund or business.

Care should also be taken as Treasury considers other comments that suggest the ability to create “feeder partnerships” or other structures that allow for more efficient capital formation and deployment. While we generally support efforts to better enable investors to connect with QOZBs, such structures could raise new risks or consequences of the compounded use of “substantially all.”

### **Conclusion**

Thank you for the opportunity to comment on the NPRM. We recognize the importance of the proposed and final regulations for OZs and QOFs, and we appreciate the open dialogue with Treasury and the IRS. For more information on the U.S. Impact Investing Alliance or to further discuss any elements of the above comments, please contact me at [f.seegull@fordfoundation.org](mailto:f.seegull@fordfoundation.org).

Respectfully submitted,



Fran Seegull  
Executive Director  
U.S. Impact Investing Alliance

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<sup>11</sup> 83 FR 54279 <https://www.federalregister.gov/d/2018-23382/p-64>