Baker & McKenzie LLP

300 East Randolph Street, Suite 5000
Chicago, IL 60601
United States

Tel: +1 312 861 8000
Fax: +1 312 861 2899
www.bakermckenzie.com

February 13, 2019

The Honorable Steven Mnuchin
Secretary of the Treasury
U.S. Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

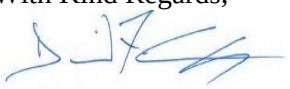
The Honorable Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution, Avenue, N.W.
Washington, D. C. 20224

RE: Treasury Department's Hearing on Qualified Opportunity Zone Regulations

Dear Secretary Mnuchin and Commissioner Rettig:

Accompanying this letter you will find a copy of my written testimony submitted on behalf of the Institute for Portfolio Alternatives (IPA) in connection with the Treasury Department's hearing scheduled to occur on February 14, 2019 regarding the proposed and pending Qualified Opportunity Zone regulations.

With Kind Regards,



Daniel F. Cullen, Esq.
Partner
Baker & McKenzie LLP

Encl. Exhibit - Written Testimony of Daniel F. Cullen, Esq. for the Treasury Department's Hearing on Qualified Opportunity Zone regulations submitted on behalf of the IPA.

Exhibit

Written Testimony of Daniel F. Cullen, Esq.for the Treasury Department's Hearing on Qualified Opportunity Zone Regulations submitted on behalf of the IPA

Opening Remarks

Good morning. My name is Dan Cullen, and I'm a partner at Baker & McKenzie LLP in Chicago, and a Director at the Institute for Portfolio Alternatives, or the IPA. Today I'm speaking on behalf of the IPA, which represents approximately 200 member companies and over 1,500 individual members involved in all aspects of the nation's portfolio diversifying investments industry. The IPA brings together the investment managers, broker-dealers, investment advisers and industry service professionals who are dedicated to driving transparency and innovation in the marketplace.

On behalf of the IPA, I appreciate the time and effort that the Treasury Department and the IRS have devoted to developing the QOZ proposed regulations, as well as the opportunity to speak to you today with respect to the proposed and pending QOZ regulations. My testimony today highlights some of the key issues from our comment letter.

First, we ask for clarification that investors in a QOF making the basis step-up election in their QOF interest after 10 years may receive the benefit of such basis increase when a QOF sells assets in connection with a desired exit strategy as part of an overall plan of liquidation and redemption of the QOF interests (in full or in part).

The benefit of the fair market value basis step-up election under Section 1400Z-2(c) should be available where the relevant disposition of the investment is structured as a sale of assets by the QOF (or its lower-tier entities) in connection with a plan of liquidation that includes a partial or full redemption of the investors' QOF interest as part of the overall transaction.

When a QOF, structured as a partnership for U.S. federal income tax purposes, disposes of an asset in connection with a plan of liquidation that includes a partial or full redemption of the investors' QOF interest, the investors should be allowed to elect to receive (i) a step-up in their share of the QOF's basis in an asset immediately before the asset is sold, as well as (ii) a corresponding basis step-up in the basis of their QOF interests. The qualified investors should be allowed to use this mechanic multiple times where a QOF disposes of its assets on an incremental basis in connection with a plan of liquidation, as long as it includes a partial or full redemption of the investors' QOF interest. Failure to provide this clarification may cause QOFs to structure their ultimate exits as only QOF interest sales. In such cases, history has shown that prospective buyers will demand a discounted purchase price to account for concerns over latent liabilities that may or may not exist in the QOF or its lower-tier entities. This result will create an economic penalty to the investors unintended by Congress. In contrast, an asset sale would not create such an unintended economic penalty and, as long as the plan of liquidation includes a redemption feature, the statutory requirements in Section 1400Z-2 are fully satisfied.

Second, we seek clarification that normal partnership tax rules apply with respect to the use of debt financing proceeds by a QOF and lower-tier entities, as well as clarification as to special QOF restrictions, if any.

Clarification is needed with regard to the permitted use of debt financing proceeds by a QOF. For example, it is not uncommon for real estate partnerships to make debt-financed distributions

from debt proceeds obtained after the development is completed, the property's operations have stabilized, and the value of the property has appreciated. Debt-financed distributions are generally not taxable to a partner unless the distribution exceeds the partner's adjusted tax basis in its partnership interest (which has been increased by the partner's share of the debt funding such a distribution). Investors in QOFs are looking for a high level of clarity in the mechanics of how general tax principles apply to their investment in QOFs and an understanding that certain ordinary transactions will not be viewed as abusive, particularly for those QOFs structured as partnerships.

We recommend including examples in the final regulations clarifying the permitted use of debt financing proceeds by a QOF. The regulations should illustrate how a QOF can make a debt-financed distribution in the same manner as any other partnership without impacting the qualification of the QOF, and that the treatment of the distribution will simply follow general tax principles. The Treasury has already provided similar clarifying statements in Proposed Regulations Section 1.1400Z-2(a)-1(b)(3)(ii) with respect to QOF investors that use their QOF interest as collateral for a loan by indicating that this would not disqualify the gain deferral election.

Further, in order for QOFs to attract the capital needed to spur economic growth in low-income communities, investors need assurance that the funds will not be subject to overly restrictive limits on traditional and customary refinancing transactions. Debt distribution rules that result in gain recognition, loss of QOF status, loss of the five-year and seven-year basis step-ups, or loss of the 10-year basis step-up, would negatively impact capital formation and the success of the QOZ program.

The final regulations should clarify that QOFs can refinance QOZ assets and distribute proceeds without triggering recognition of the deferred gain, provided the refinancing does not reduce the fair value of equity in the QOF interest below the level of the original deferred capital gain. The rules should permit refinancing on the increase in value of the deferred gain contribution (with an administrative safe harbor for growth supported by a third-party appraisal). A distribution, however, would be subject to the general rules of Subchapters C and K, as the case may be. A partnership should be permitted to revalue its capital accounts under Treasury Regulations Section 1.704-1(b)(2)(iv)(f) to properly reflect the economics of such a refinancing and distribution. A rule that requires QOFs to retain equity value equal to the initial deferred amount would represent a balanced approach, ensuring the program leads to long-term, patient investment in low-income communities while also allowing opportunity funds to compete for capital with traditional real estate funds that are not subject to debt distribution restrictions.

Third, we seek clarification relating to the impact, if any, of certain tax-deferred transactions on the fair market value basis step-up election available under Section 1400Z-2(c).

Both the statute and the proposed regulations are unclear about the impact of certain tax-deferred transactions (e.g., stock-for-stock mergers or a Section 721 transaction, like an UPREIT transaction) on the 10-year basis step-up available under Section 1400Z-2(c).

We recommend including examples in the final regulations clarifying the permitted use of certain tax-deferred (basis carryover) transactions by a QOF. The regulations should illustrate how a QOF can utilize such transactions in the same manner as any other entity without impacting the qualification of the QOF, and clarify that the transaction will simply be governed by existing rules under the Code and general tax principles.

Finally, we ask for clarification relating to a QOF or its lower-tier entities' ability to sell assets and roll into new QOZ property with the ability to tack the holding period incurred on the relinquished property, while maintaining the long-term tax benefits under Section 1400Z-2.

The final regulations should clarify that if a QOF (or its lower-tier entity) sells an asset and reinvests in another QOZ asset within 12 months of the sale, the QOF is allowed to tack on the holding period of the old investment for purposes of the five, seven, and 10-year rules for the new investment. Here, the key point is that the investor's capital remains committed to QOZ investment. This is consistent with the proposed rule deferring gain recognition when an investor sells a QOF interest and reinvests in another QOF.

These flexible reinvestment rules will contribute to a more efficient market, with capital flowing to its best use, and they will encourage investors and funds to remain committed and invested in the designated communities.

Closing Remarks

Thank you, again, for the opportunity to present this testimony today on behalf of the IPA. The IPA looks forward to continuing to work with the Treasury and the IRS as you move forward to finalize the proposed regulations, and I will be happy to answer any questions you may have.