December 28, 2018

The Honorable David J. Kautter
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

The Honorable Michael J. Desmond
Chief Counsel
Internal Revenue Service
1111 Constitutional Avenue, N.W.
Washington, D.C. 20224

RE: Comments to Proposed Regulations Concerning the Qualified Opportunity Zone Proposed Regulations Under Section 1400Z-2 of the Code (REG-115420-18).

Dear Assistant Secretary Kautter and Chief Counsel Desmond:

The International Council of Shopping Centers ("ICSC") appreciates the opportunity to provide comments on the proposed regulations titled "Investing in Qualified Opportunity Funds" under Section 1400Z-2 of the Internal Revenue Code (hereinafter the "Proposed Regulations").

Founded in 1957, ICSC is the global trade association of the shopping center industry. Our more than 70,000 members in over 100 countries include shopping center owners, developers, managers, investors, retailers, brokers, academics, and public officials. The shopping center industry is essential to economic development and opportunity. It is a significant job creator, driver of GDP, and critical revenue source for the communities it serves through the generation of sales taxes and the payment of property taxes. These taxes help communities pay for teachers, first-responders, and infrastructure like roadways and parks. Shopping centers aren't only fiscal engines—they are integral to the social fabric of our communities by providing a central place to congregate with friends and family, discuss community matters, and participate in and encourage philanthropic endeavors.

ICSC commends the Treasury and the IRS for the overall helpful and practical clarifications provided in the Proposed Regulations, including clarifications regarding (i) the calculations for the "substantial improvement" test involving land and building; (ii) deemed contributions under Section 752 not creating a separate Qualified Opportunity Fund ("QOF") investment; and (iii) clarifying the quantification of "substantially all" and the working capital exception for lower-tier Qualified Opportunity Zone ("QOZ") partnerships and stock.

As the Treasury and IRS finalize the proposed regulations we would request that you clarify the following additional items:

I. Section 1231 capital gain clarifications. Clarify that allowable Section 1231 capital gains invested in a QOF are defined as "section 1231 gain" under Section 1231(a)(3)(A) and that any loss netting under Section 1231(a)(1) would apply to invested gains after the QOF deferral period ends (e.g., 2026).

II. REIT capital gain reinvestment window. Start the 180-day window under Section 1400Z-2(a)(1)(A) with respect to REIT capital gain dividends upon the REIT's declaration of the dividend as a capital gain dividend on January 30 of the following year.

III. Substantial improvement test for "ground up" development and multi-building development. Provide guidance that ground-up development in a QOZ satisfies either the Section 1400Z-2(d)(2)(D)(i)(II) "substantial improvement" or "original use" test and further guidance on how the substantial improvement test applies for a single real estate development involving multiple buildings.

IV. Clarify that QOZ business property includes all rental real estate. Clarify that the term tangible property used in a trade or business of the QOF under Section 1400Z-2(d)(2)(D)(i) includes all rental real estate regardless of type of lease.

V. Provide eligible continuing investment of historical property owner outside of QOF. Provide that a QOF can co-invest through a partnership or otherwise with a pre-2018 property owner in a QOZ.

VI. Clarify that a QOF partnership can make debt-financed distributions to investors. Clarify that there is not a restriction under Section 1400Z-2 that would prohibit a QOF partnership from making a debt-financed distribution to investors, at least to the extent that such refinancing proceeds are limited to the investor's share of post-contribution appreciation in the QOF.

VII. Provide that a QOF investor's outside basis step-up election creates a corresponding asset basis increase in the QOF partnership assets. The statute provides that a QOF investor receives a basis increase in their QOF interests upon election after a 10-year holding period but guidance is requested to provide that such basis increase is also reflected in the investor's share of a QOF partnership assets such that the investor is not taxed on the gain from a partnership-level sale of assets after the partner makes the basis step-up election.

VIII. Clarify how the working capital safe harbor works with a blind-asset pool fund. The working capital safe harbor requires a written schedule consistent with the ordinary start-up of a trade or business for the expenditure of the working capital assets, but it is unclear how this works for a fund that receives cash in a "blind pool" for properties that are to be acquired in the future but not known at the time the QOF receives its capital contributions.

IX. Toll the 31-month working capital safe harbor for uncontrollable construction delays. Provide a tolling of the 31-month working capital safe harbor for delays beyond the QOF's control.

I. Section 1231 capital gain clarifications

The Proposed Regulations clarify that gain is eligible to be invested in a QOF if such gain is "treated as a capital gain for Federal income tax purposes." Section 1231 clearly causes gains to be "treated as" capital gains. Specifically, Section 1231(a)(3)(A) defines "section 1231 gain," which will be treated as capital gain, but only after netting with any Section 1231 losses pursuant to Section 1231(a)(1). The Proposed Regulations confirm that a partnership is an eligible taxpayer to invest capital gains in a QOF. A partnership can readily determine if it has "section 1231 gain," however, the specific netting of such section 1231 gain against section 1231 losses to determine net gain is instead performed at the partner level. See generally Rev. Rul. 67-188. Thus, in order for partnerships to be able to invest Section 1231 gains into a QOF, we request clarification that section 1231 gain defined under Section 1231(a)(3)(A) be considered eligible gain for this purpose. Thus, the second step of section 1231 loss netting will instead be applied when the deferred gain is recognized under Section 1400Z-2(b)(1), consistent with the capital gain character retention rules in the Proposed Regulations. This mechanism should not be limited to partnerships as it also allows a non-partnership taxpayer who directly recognizes section 1231 gains to invest within the 180-day window as such taxpayer would otherwise risk his or her gain being ineligible if later in the same tax year there are offsetting section 1231 losses (e.g., a section 1231 gain recognized on January 1 must be invested by July 1 but the taxpayer would otherwise not know if there were any offsetting section 1231 losses July 1 to December 31).

II. REIT capital gain reinvestment window

The Proposed Regulations provide that a REIT shareholder has 180 days from the REIT's payment of the capital gain dividend to make a QOF investment. However, the shareholder will not know if a dividend is a capital gain dividend at time of payment but will instead only know when the REIT "declares" that a dividend is a capital gain dividend, the deadline of which is January 30 of the following year under Section 857(b)(3)(B). Thus, we recommend that the regulations provide that the 180-day investment period for a REIT shareholder start upon the January 30 REIT capital gain declaration date with respect to REIT capital gain dividends.

III. Substantial improvement test for "ground up" development and multi-building development

The Proposed Regulations specifically exclude the basis of land from the amount that needs to be doubled under Section 1400Z-2(d)(2)(D)(ii) for a building to be substantially improved under the theory that it facilitates repurposing vacant buildings in qualified opportunity zones. However, the Proposed Regulations reserve for other questions relating to land and improvements on land and certain key questions remain.

For "ground up" development where there is no existing building at all (or perhaps an existing structure is demolished and capitalized into the land), there is need for guidance that such new construction can meet the "substantial improvement" or "original use" test under Section 1400Z-2(d)(2)(D)(i)(II) and the "acquired by the QOF by purchase" test under Section 1400Z-2(d)(2)(D)(i)(I). The Preamble to the Proposed Regulations implies that such vacant land

development is eligible when stating that "an absence of a requirement to increase the basis of land itself would address many of the comments that taxpayers have made regarding the need to facilitate repurposing vacant or otherwise unutilized land." Thus, we believe the intent is clear but more specific guidance in the text of the regulations confirming that building on vacant land is considered a purchase and confirming exactly how the "doubling of basis" test applies where there is no building to compare the cost of the improvements against.

Another mechanical question relates to how to apply the substantial improvement test when there are multiple buildings in a single project. For example, an existing parcel might be acquired for purposes of building both the main shopping center building and also a related building in the same development. Similarly, when acquiring an existing property there could be multiple buildings on a single property. We presume that these multiple integrated buildings would be added together for purposes of the "doubling of basis" test, but clarification is needed as the statute refers to "property," which can include multiple buildings. The Proposed Regulations currently only address situations involving a single building.

IV. Clarify that QOZ business property includes all rental real estate

Section 1400Z-2(d)(2)(D)(i) defines QOZ business property by reference to "tangible property used in a trade or business of the QOF." There is currently no definition of trade or business and the Proposed Regulations reserve on defining the phrase "active conduct of a trade or business." As the QOZ rules are designed to encourage development of real estate in underserved areas, we believe that the type of lease, whether "triple-net" or otherwise, should be irrelevant in qualification of a property. To do otherwise risks an entire QOZ development from qualification merely because the ultimate person requesting to rent the property seeks a certain kind of lease. The intended benefit of a QOZ development has occurred regardless of the type of lease and we are concerned that if the regulations adopt a Section 162 standard as has recently been done in other contexts, there will be an unintended result that certain leases could cause the property to not qualify as a QOZ trade or business. Furthermore, we note that our proposed clarification would be consistent with rental real estate qualifying as Section 1231 "property used in the trade or business," regardless of the type of lease.

V. Provide for the continuing investment of historical property owner outside of QOF

We note that Section 1400Z-2 does not allow a person who owned the property in the QOZ pre-2018 to be "related" to the QOF (generally defined as owning 20% or more of the QOF). It is common in real estate developments for an existing property owner to only sell a partial interest in property to a developer and "roll over" a portion of their original equity. We recognize that a QOF must "purchase" the property, but it would be helpful to have clarification that a QOF could purchase a partial interest in the property such that the historical owner could "roll over" part of their investment via a lower-tier partnership. The historical owner would not be seeking QOF tax benefits and the substance would be in compliance with the intent of the QOZ rules. For example, if a QOF purchases 60% of an LLC owning the property and the QOF and historical owners are now 60-40 partners in the LLC, we request clarification that this 40% owned outside of the QOF does not cause qualification concerns under either the definition of QOZ partnership or under the prohibition against having 5% or more nonqualified financial property under Section 1397C(b).

VI. Clarify that a QOF partnership can make debt-financed distributions to investors

The Proposed Regulations clearly state that deemed contributions under Section 752(a) from partnership borrowings do not create a QOZ investment and the basis from the debt is not taken into account in determining the portion of the partner's investment subject to the QOZ rules. However, the Proposed Regulations do not address distributions funded from a partnership borrowing. It is common practice for partnerships to borrow at the property level after an increase in value in a developed property to fund partner distributions (as banks prefer to loan at the property-level). Guidance is needed as to the treatment of such debt-financed distributions from a QOF. We request that, at a minimum, future guidance clarify that such borrowing and cash distributions that does not exceed a partner's share of the growth in value of its QOF interest should not affect qualification of the QOF investment for the 10-year holding period. Thus if partners A and B each contributed $1,000,000 into QOF Partnership to buy Property and after five years Property has increased in value to $3,000,000, we request guidance that QOF Partnership can borrow up to $2,000,000 to distribute to A and B and not be viewed as a reduction in A and B's originally tax deferred QOF investment, i.e., that it would simply follow existing tax rules for how to treat such distribution (e.g., a tax-deferred distribution to the extent of a partner's basis in the QOF Partnership).

VII. Provide that a QOF investor's outside basis step-up election creates a corresponding asset basis increase in the QOF partnership assets

Section 1400Z-2(c) provides that for QOF investors who have met the 10-year holding period, "the basis of such property shall be equal to the fair market value of such investment on the date that *the investment is sold or exchanged*" (emphasis added). The ICSC recognizes that the QOF tax benefits are determined at the partner/investor level with respect to their interest in the QOF, but respectfully request that this basis increase be allowed to be "pushed down" to the underlying QOF partnership assets using the mechanics of the existing Section 743(b) rules. This would avoid the unnecessary artificial sale of QOF interest when a more traditional transaction would involve a sale of property by the QOF. Although we recognize that the statute refers to having the basis step up on the date that the "investment" is sold or exchanged, we believe it is reasonable for the regulations to look to the direct and indirect investment, which would include the underlying property held by the QOF.

VIII. Clarify how the working capital safe harbor works with a blind-asset pool fund

The working capital safe harbor requires a written schedule consistent with the ordinary start-up of a trade or business for the expenditure of the working capital assets, but it is simply unclear what is treated as sufficient for this purpose for a fund that receives cash in a "blind pool" for properties that are to be acquired in the future but not known at the time the QOF receives its capital contributions. Examples of what type of detail is needed in this written description and when this schedule is needed would be helpful to facilitate such funds.

IX. Toll the 31-month working capital safe harbor for uncontrollable construction delays

The working capital safe harbor provides a practically necessary mechanism to satisfy the QOF mechanical rules. However, the safe harbor has a strict term of 31 months, but in construction there are many events that can cause material delays outside of the developer's control, such

as natural disasters, governmental mandated construction halts for events, permit delays, or environmental delays. Therefore, we request a tolling of the 31-month working capital safe harbor for delays beyond the QOF's control.

ICSC thanks you for considering the above comments. We welcome the opportunity to discuss these in more detail. For further questions, please contact Phillips Hinch, Vice President of Tax Policy, at phinch@icsc.org or (202) 626-1402.

Sincerely,

Tom McGee
President and Chief Executive Officer
International Council of Shopping Centers