December 6, 2018

Internal Revenue Service
CC:PA:LPD:PR (REG-115420-18)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: **QOF Proposed Regulations**

Dear Sir or Madam:

We have been asked by our client Counterpoint LLC to comment on certain aspects of the proposed regulations that were published in the October 29, 2018 Federal Register (83 FR No. 209, pages 54279 - 54296) (the "proposed regulations") providing guidance with respect to the qualified opportunity zone ("QOZ") incentives and qualified opportunity fund ("QOF") investments contained in Section 1400Z-2 of the Internal Revenue Code.

We would first note that the proposed regulations (and Revenue Ruling 2018-29 issued concurrently with the proposed regulations) do a very good job of giving preliminary guidance for investment in real estate in qualified opportunity zones, but have reserved or are silent on certain key terms and provisions that are critical for investments in businesses that depend heavily on intangibles or have customers who do not reside in the QOZ. We understand that some of the open issues will be dealt with in a second set of proposed regulations which are expected to be issued shortly. We write to highlight some of those issues.

The statutory requirements contained in Code Section 1400Z-2(d)(3)(A), regarding what constitutes a qualified opportunity zone business conducted by a partnership or corporation (a "QOZ subsidiary") in which a QOF owns stock or partnership interests, are somewhat clarified by the proposed regulations. The statutory provisions require that:

- at least 50% of the gross income of the QOZ business is "from" the active conduct of a trade or business "in" the QOZ,
- a "substantial" portion of the intangible property of the business is "used in the active conduct" of such trade or business "in" the QOZ
- less than 5% of the aggregate unadjusted basis of property of the business is attributable to nonqualified financial property (such as cash, debt, swaps etc., but not including reasonable amounts of working capital), and

- substantially all of the tangible property owned or leased by the QOZ business is property purchased after 2017 that is originally used in the QOZ (or satisfies a doubling of the property's basis test).

The proposed regulations provide that the substantially all test in this last bullet means at least 70% of the tangible property owned or leased by a QOZ Subsidiary (based on the applicable financial statement of the QOZ business or, if it has none, its cost). It should be noted that the statutory requirements described in the first 3 bullet points do not apply to a QOF that owns its QOZ business property directly, but then at least 90% of **all** its assets must consist of tangible property. See Code section 1400Z-2(d)(1).

It would be very helpful for the IRS to provide guidance that addresses the following questions:

- When will a QOZ business be treated as engaged in the active conduct of the QOZ business? For example, if a startup is just spending money on R&D, is that active enough for these purposes?

- What constitutes a "substantial portion" of the intangible property of the business? We would suggest that 40% is a substantial portion, based on the use of that percentage for the new markets tax credit. See Treas. Reg. §1.45D-1(d).

- Is cash used for advertising, research and development or other purposes eligible for the working capital exception? We would suggest that cash used for expenses to create or buy intangible property be eligible for the same 31-month safe harbor that is provided for cash that is used by a QOZ business to acquire or construct ***tangible*** property pursuant to a written schedule.

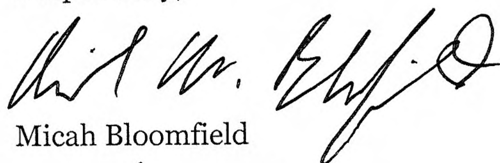
- Under what circumstances should a business be treated as being conducted (and intangible assets be considered to be used) in the zone? For example, should this determination be made solely based on the location of employees and/or tangible assets of the business? We believe those factors should be determinative. Should the location in which property is sold or services are provided be relevant? We believe they should not be, at least if the employee or tangible asset tests are met. Based on the use of 40% for purposes of the new markets tax credit, we would suggest that a business would be considered conducted in qualified opportunity zones if at least 40% of the tangible assets of the business are in one or more QOZs or at least 40% of the employees of the business are employed in QOZs.

Additional clarifications that would be critical to answer for almost all businesses would include the following:

What are the consequences when property or cash is distributed by a QOF?

What year or years must an entity qualify as a QOF for the investment in the QOF to be entitled to the deferral, 5-year, 7-year and 10-year benefits? Cf. Code sections 1400Z-2(d)(2)(B)(i)(III) and -2(d)(2)(C)(iii) (a QOZ business must be qualified for substantially all the QOF's holding period). Does the answer differ depending on which benefit the investor is seeking to qualify for? Is it affected by the activities of the QOF after 2027?

Respectfully,



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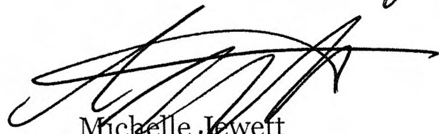

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