DHCD
Maryland Department of Housing and Community Development

LARRY HOGAN
Governor

BOYD K. RUTHERFORD
Lt. Governor

KENNETH C. HOLT
Secretary

TONY REED
Deputy Secretary

December 21, 2018

Steven T. Mnuchin
Secretary of the Treasury
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

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

Dear Secretary Mnuchin,

On behalf of the State of Maryland, thank you for the opportunity to comment on proposed regulations and rule making under the 2017 Tax Cuts and Jobs Act, which created the Opportunity Zone program. Please consider the following recommendations for the proposed Opportunity Zone regulations. We believe that these proposed changes are necessary for the State of Maryland, and all states, to support housing, science, technology, and new economy industries, which are critical to the nation's future growth and prosperity.

Maryland ranks highly in new economy businesses that should receive the benefits of the Opportunity Zone tax incentive:

- Maryland ranks third in the Milken Institute's biennial State Technology and Science Index for 2016. According to study results, Maryland received top ten rankings in all of the index components, including first in the technology and science workforce as well as the technology concentration and dynamism categories.

- Maryland ranks sixth in the 2017 State New Economy Index, a measure of a state's economy as knowledge-based, globalized, entrepreneurial, information technology-driven and innovation-based.

- Maryland/Virginia/Washington DC Metro places fourth in a ranking of the top ten U.S. biopharma clusters based on criteria including patents, NIH grant funding, venture capital, lab space and number of jobs.

OFFICE OF THE SECRETARY
MARYLAND DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT
7800 HARKINS ROAD, LANHAM, MD 20706
301-429-7461, TOLL-FREE 800-756-0119, FAX 240-334-4732

- Maryland places second in WalletHub's State Innovation Index based on 22 indicators including share of STEM professionals, R&D spending per capita, tech company density, and other human capital and innovation environment factors.

- Maryland ranks fifth in the Bloomberg U.S. Innovation Index, which scores states based on six metrics including R&D, productivity, high tech density, STEM employment, science and technology degrees and patent activity.

- Suburban Maryland/Metro DC, spanning the Bethesda, Rockville and Gaithersburg areas in Montgomery County northwest to Frederick County, ranks sixth among U.S. life sciences clusters. The ranking is based on life science establishment and employment concentration, venture capital and NIH funding, as well as life sciences real estate supply, occupancy and rent.

- Maryland ranks highly in the technology intensity of its business base. The state ranks fourth in science, engineering and technology (SET) establishments as a share of all business establishments (12.3%), third in employment in SET establishments as a share of all employment (16.9%), and seventh in SET business formation as a percent of all business establishments.

- Maryland ranks fifth and is an "Innovation Champion" according to the Consumer Technology Association's 2018 Innovation Scorecard. The ranking is based on 12 criteria that include sensible tax structures and policies allowing cutting-edge technologies and new business models to flourish, all of which creates high-quality jobs and healthy economic growth.

Again, thank you for allowing us to comment on proposed rules for the Opportunity Zone program. We strongly believe Opportunity Zone tax benefits will encourage long-term investment in distressed communities nationwide and spur economic development and job creation in places that need it the most. We hope that our recommendations, along with those of other states and stakeholders, will be useful to you in implementing this critical program.

Sincerely,

Kenneth C. Holt

Kenneth C. Holt
Secretary

RECOMMENDATIONS

I. Qualified Opportunity Fund (QOF) and Types of Qualified Businesses

A. A Qualified Opportunity Fund (QOF) should be able to invest in the stock or partnership interests of a wide range of business types. The QOF statute differs from the Empowerment Zone and New Markets Tax Credits statutes in that it does not exclude specific categories of businesses beyond the "sin businesses." As described below, future regulations and guidance should provide flexibility to implement the statutory intent to include a broad array of businesses and exclude only the "sin businesses" that are specifically identified in the Act.

II. Regulations for Qualified Opportunity Stock and Qualified Opportunity Zone Partnership Interests (QOZ Subsidiaries) and Qualified Opportunity Zone Business Property

A. Treasury should provide further guidance relating to QOZ Businesses by providing flexible rules to allow existing businesses operating in a Qualified Opportunity Zone (QOZ) to qualify and attract QOF investment. The requirement that substantially all (defined in the proposed regulations as 70%) of the tangible property of a QOZ Business be Qualified Opportunity Zone Business Property will eliminate many businesses that began operations in a QOZ prior to enactment of the Act. Even if the QOF equity infusion in a business is used to expand a facility or acquire new equipment, the value of buildings and equipment existing in the QOZ before date of enactment of the Act will have to be low in order for the existing business to meet the 70% test. For a business involved in developing intangible assets as an interim asset class that may lead to a potentially successful commercialization of end products, i.e. research and development of successful drugs that will result in scaled up manufacturing capacity, such intangible assets should be counted toward meeting the 70% test.

B. Treasury should adopt regulations designed to facilitate QOF investments into existing operating businesses whose property is primarily intangible. These businesses often seek additional QOF investment to develop intangibles and not to substantially improve tangible property. Accordingly, in order to meet the substantial improvement test, these businesses are effectively required to improve tangible property when that may not be consistent with their business objectives. While the fact that they may have minimal tangible assets at the outset may facilitate compliance when operating as a QOF subsidiary, Treasury should provide further guidance relating to the applicability of the substantial improvement requirement to double the basis of tangible assets of a business over any 30 month period. Specifically, the Department notes that research and development (R&D) intensive industries starting up or expanding into a QOZ may have a large intangible asset on their books related to the development of science, technology, engineering, and math (STEM), including software, businesses. The creation of, or increase in, R&D assets should be counted for purposes of the "substantial improvement" and facilitate the enjoyment by these businesses of the same tax benefits as businesses with predominantly tangible assets that undergo substantial improvement, since they also drive economic development in the QOZ. The substantial improvement rule seems to apply only to tangible property. Therefore, a regulatory clarification to allow the intangible property as qualified opportunity zone property for purposes of the substantial improvement test should meet the intent of the existing QOZ legislation and would enable capital investments in QOZ for these types of enterprises leading to job creation and economic development in underserved areas.

C. Treasury should provide further regulatory guidance relating to the 90% asset test in general and particularly with respect to businesses with predominantly intangible assets. For purposes of this test, cash holdings resulting from cash equity investments held at the QOF level that are designated in advance in writing for R&D and software development should be QOF-eligible investments. If this is not the case, then only 10% of total QOF investments could be designated as working capital. This would be unreasonably restrictive to these types of businesses and would effectively block them from receiving a QOF investment.

D. Similarly, Treasury should provide further guidance relating to the 5% nonqualified financial property test exception as applicable to QOF subsidiary so that it will apply to R&D intensive businesses. In particular, it would be helpful for the regulations to confirm that intangibles such as patents and trademarks are not nonqualified financial property – so a QOF subsidiary's R&D business can hold its intellectual property without violating the 5% test.

E. With respect to cases where the QOF is making an equity investment in a QOZ business, Treasury should provide further guidance relating to the reasonable working capital exception from the 5% nonqualified financial property limitation on a QOZ business. A QOF subsidiary is allowed to retain "reasonable working capital" and the recently proposed regulations provide a 31-month safe harbor for working capital to address concerns expressed to the Internal Revenue Service (IRS) and Treasury that funds would be held and invested while a business acquired, constructed, or rehabilitated a project – tangible property. This safe harbor does not provide relief for cash held by a QOF subsidiary using funds from a QOF to finance work on intangibles. Therefore, Treasury should adopt a safe harbor that provides guidance on the reasonable amount of working capital that an operating business may hold, with special attention to the working capital needs of companies that are producing intangibles, like software or patents. This safe harbor might, for example, require that the R&D subsidiary business have in place a written description and schedule for development of intangible asset holdings.

F. Treasury should provide further guidance on the sourcing of revenue derived from activities of a QOZ business in a QOZ. The Act requires that 50% of gross income come from QOZ-located activities, but regulations should provide taxpayer-friendly sourcing rules, including for a business distributing its products outside its domicile location in a QOZ. Treasury regulations under section 1394 of the Internal Revenue Code provide a specific example affirming the qualification of a mail order business in the Empowerment Zone context that offers a reasonable approach to this potential problem.

G. Treasury should provide further guidance related to start-up companies locating in a QOZ. Innovative start-up companies may need to adjust timelines to investor participation agreements, company buyouts, and other business adjustments related to investors, public offerings, or reorganization. For purposes of the 90% asset test, regulations should be taxpayer friendly in allowing for a QOF to roll over a QOZ investment into another QOZ investment or hold proceeds in cash in order to complete the five, seven or ten-year holding periods to avoid losing tax benefits relating to applicable holding periods (i.e., the ten-year holding period that eliminates capital gains tax).

H. Treasury should provide simple, clear, and flexible guidance relating to all aspects of deployment and redeployment of capital gains and other funds in to and out of a QOF, including timelines relating to fund transfers. Guidance should include clarifications related to the use of "cash" or "cash equivalents," grace periods (three years or more) to divest business property that ceases to be Qualified Opportunity Zone Property (QOZP), and safe harbors to avoid inadvertent or premature disqualifications.

I. Treasury should confirm that leasing activities, particularly the leasing of residential real estate, constitute a qualified opportunity zone business property.

J. Treasury should consider making changes to the low income housing tax credit (LIHTC) and tax-exempt bond regulations to allow for an automatic basis boost for QOZ-located projects. Changes could provide for the basis boost or other rules could be implemented in order to synchronize the tax benefits of affordable housing projects with QOZ investments. Doing so may provide greater investor certainty and LIHTC pricing. Using LIHTC with QOF investments could help states fund better quality and more affordable housing.

K. Treasury should consider exempting affordable housing projects in Opportunity Zones from QOZ compliance reporting. Existing compliance reporting to a federal entity, required for LIHTC and / or tax-exempt financed projects, should be deemed sufficient.

L. Treasury should provide guidance on using QOF investments to satisfy requirements pertaining to certain depository institutions under the Community Reinvestment Act (CRA).

M. Treasury should provide clarification relating to the five- and seven-year tax exemptions and tax deferrals for QOZ investments made closer to December 2026 and before the ten-year QOZ designation period ends.