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Room 5203

Internal Revenue Service

P.O. Box 7604

Ben Franklin Station

Washington, DC 20044

Attn: Erika C. Reigle and Kyle C. Griffin

Re: REG-115420-18 – Treasury Proposed Regulations on Opportunity Zones; Application to Timber and Rural Opportunity Zones

Dear Sirs,

On behalf of and in connection with the Forest Landowners Association¹, American Timberlands Company, Capital Innovations, LLC and Resource Management Service, LLC, we welcome the opportunity to provide the foregoing comments on Treasury Department ("**Treasury**") proposed regulations 1.1400Z-2(a) through (e) (the "**Proposed Regulations**") and Revenue Ruling 2018-29 (the "**Ruling**") relating to the implementation of section 1400Z-2 of the Internal Revenue Code (the "**Code**") on opportunity zones ("**Opportunity Zones**"). In particular, we have set forth below a number of interpretative comments, based on those set forth by the Treasury, which seek to clarify the application of the Code in rural Opportunity Zones and in industries where the relationship between the land and the buildings on the land involves a set of assumptions which differ from those set forth in the Proposed Regulations and the Ruling.

I. Introduction

We represent a coalition of businesses and investors engaged in economic development in primarily rural areas of the United States. In particular, our constituents are involved in timber, mining and agriculture, and are seeking to achieve additional clarification on the application of the Proposed

¹ The Forest Landowners Association (FLA) is an association of landowners who are the stewards of America's private forests. FLA represents over 5,000 members, representing over 50 million acres of forest in 45 states. Our members hold predominantly large tracts of forest and manage their land with a sustainable approach, ensuring the prosperity of their forests for future generations. Our constituents range from large forest businesses whose land has been in their families for generations to those who have become forest landowners because they view forests as a long-term investment. FLA is committed to preserving America's tradition of private forest ownership, promoting the importance of forest resources, and securing a legacy that can be passed to the next generation.

Regulations in rural contexts. According to figures compiled by the Economic Innovation Group,² nearly 40% of all Opportunity Zones lie within rural environments—as many as exist in urban environments. As a result, the Opportunity Zones program presents a unique ability to infuse capital into often overlooked rural communities and to take advantage of one of America’s greatest resources: its land. Investment in these rural Opportunity Zones presents unique challenges and possibilities. A principal challenge will be to balance the land-intensive nature of rural businesses with the development focus of the Opportunity Zone statute. In the below comments, we seek to put forth a proposal to achieve that balance.

II. The Proposed Regulations

The Proposed Regulations provide a valuable framework for fostering investment in Opportunity Zones. In particular, we note that, pursuant to Proposed Regulation 1400Z-2(d)-1(c)(8), “a substantial improvement to the purchased tangible property [including land and any building upon such land] is measured by the QOF’s additions to the adjusted basis of the building [on such property],” and that this “does not require the QOF to separately substantially improve the land upon which the building is located.”³ This position is reiterated in the Ruling, which adds one additional point of clarification: “Given the permanence of land, land can never have its original use in a QOZ commencing with a QOF.”⁴ Taken together, these statements appear to (i) prohibit application of the “original use” test to land and (ii) excuse the land itself from having to qualify under the substantial improvement test, provided that any building thereon meets the substantial improvement test.

Since the business of rural industry often involves the commercial use of the land, and not necessarily the development of buildings on the land, by excluding land from the original use test and the substantial improvement test, the Treasury’s interpretation introduces uncertainties for land-intensive industries which could inhibit investment in rural Opportunity Zones.

III. Comments to the Proposed Regulations

In order to address the uncertainties faced by land-intensive industries, we propose a number of interpretations below which we believe may foster development in rural Opportunity Zones.

A. Original Use. As noted above, the Treasury’s proposed interpretation of the original use provision in Code section 1400Z-2(d)(2)(D)(i)(II) would prohibit its application to land itself. As a result, land-intensive industries such as timber, forestry, mining and agriculture, which may involve the original use of the natural features on the land otherwise in compliance with the Code, would be required to meet the substantial improvement test. We believe this interpretation unnecessarily restricts industries which engage in a truly “original use” of land in an Opportunity Zone by employing such land in an industry in which such land had not previously been employed. As a result, we are seeking a clarification from the Treasury that industries would be able to avail themselves of the original use test where such industries engage in cultivation which had not previously occurred on the land, whether through

² <https://eig.org/news/opportunity-zones-map-comes-focus>

³ Proposed Regulation 1400Z-2(d)-1(c)(8)(ii)(A).

⁴ Revenue Ruling 2018-29, page 3.

forestry, mining, farming or otherwise. In order to avail themselves of the test, we propose that property owners be required to demonstrate that substantially all of such land is used in the active business of the relevant land-intensive industry.

B. Substantial Improvement. Under Code section 1400Z-2(d)(2)(D)(i), property may alternatively meet the substantial improvement test rather than the original use test, though such property remains subject to the requirement that it be “used in a trade or business of the QOF.” Under the Treasury’s proposed interpretation, a property owner would apply the substantial improvement test to a building on the land, but exclude the value of land itself from application of the substantial improvement test. Despite this, the land itself would continue to retain its status as qualified opportunity zone property for purposes of the 90% test set forth in Code section 1400Z-2(d)(1). While we believe this interpretation presents a helpful clarification of the application of the Code in urban contexts where development focuses on the construction or rehabilitation of buildings, the “used in a trade or business” requirement raises concerns for managers of investments in rural industries.

Notably, we are seeking to clarify the application of this principle in contexts where any buildings on the land cover a fraction of the overall area of the property. For example, the use of land in a business is clear in a context where the land is proportionate to any buildings constructed on the land (e.g., a 10 acre plot with a building spanning 8 acres), since the land is being used to support the building. However, it is less certain how this trade or business test would be applied where the land is substantially larger than any buildings thereon (e.g., a 100 acre plot with a 1 acre building). A strict reading of the Treasury’s Proposed Regulations and Ruling here would require that, in the latter case, an investor would be permitted to take advantage of the deferral under 1400Z-2(b) in respect of its investment in the land, irrespective of the proportion of the development to the aggregate amount of land. However, this interpretation appears to be conditioned on the Treasury’s view as to when land will be deemed to be “used in a trade or business of the QOF,” and, notably, whether the Treasury’s analysis in the Ruling would apply to structures purchased or built on land other than buildings (such as roads, irrigation canals, storage facilities, timber, crops, and other physical adjustments to and upon the land, including irrigation and environmental mitigation). Such structures may have the same effective permanence and ability to provide long-term economic activity as residential and commercial buildings. Given this, we believe a further clarification on the Treasury’s interpretation would be valuable in ensuring that businesses which rely on the statute in good faith when making investments in Opportunity Zones would not be subsequently prevented from realizing the Code’s intended gain deferral provisions.

➤ Accordingly, we propose that, in the case of land-intensive development activities, that the Treasury’s existing interpretation in the Ruling would apply (i) without regard to the value of buildings constructed on such land relative to the value of such land, provided that such buildings were substantially improved, and (ii) that the Treasury’s understanding of a “building” in the Ruling would apply equally to man-made structures on the land (e.g., roads, lumberyards, farmhouses, fences, wells, mining shafts), as well as other improvements to and upon the natural elements of the land (e.g., trees,

crops, ponds, drainage, environmental mitigation); *provided* in all cases that all such tangible property, however improved, be used in the trade or business of the QOF.

➤ Finally, we are seeking clarification that the foregoing uses of physical and natural structures on the land would be deemed to be used in the trade or business of the QOF where the relevant managers of the business provide a written plan which describes how each of the foregoing properties are utilized in the trade or business.

C. Components of Rural Industry. In the foregoing technical analysis, we present the economic components of rural development in the timber industry, including a number of value-adding investment components applicable to the industry.

1. Buildings upon the Land. Rural industries may include a number of improvements to natural and man-made structures occurring on the land, such as the following:

- Planting Trees and other Cover Crops
- Ditch/Drainage Repair and Maintenance
- Road Construction and Maintenance
- Installing Gates and other Security
- Application on Fertilizer and Herbicides
- Mowing, Mulching, Chopping, Disking, and Raking Forest Understory and Debris
- Controlled burning, Landscaping
- Recreational/Wildlife Enhancements
- Wetland, Stream, and/or Threatened Species Mitigation
- Carbon Sequestration Analysis
- Construction of storage facilities, lodges, recreational facilities

While the above does not represent an exhaustive list of the types of man-made and natural “buildings” that may be constructed or improved upon the land, we believe they represent a good snapshot of various industry components. Notably, certain of the buildings fit within a conventional understanding of a man-made structure on the land, such as roads, gates, storage facilities and lodges. Natural structures, however, are more diverse and include various structural improvements to the land, such as the planting of trees and crops and development of irrigation and drainage, as well as the removal of structures from the land through landscaping, mowing, the application of pesticides and controlled burning. In addition, such natural structures may include sections of the land which must be set aside in order to meet federally mandated requirements for environmental mitigation and preservation.

➤ Accordingly, we are seeking clarification from the Treasury that both man-made structures and naturally occurring structures on the land would be eligible for the substantial improvement test. In the case of natural structures, we are seeking additional clarification that improvements would include monies spent to (i) build natural structures, (ii) remove natural structures,

and (iii) preserve natural structures; provided in all cases, that such natural structures are “used in a trade or business of the QOF”.

➤ It is notable that a farming, timber or mining business could be spending substantial sums to operate a business, although some of such expenditures, in particular expenses incurred in building or removing natural structures on the land, may not qualify as capital expenditures which would increase the tax basis of the property under the substantial improvement test. As a result, we additionally propose that "substantial improvement" of natural structures on the land be assessed based on the total expenditures made to improve such natural structures over a basis of zero.

2. Property and Property Rights. Code section 1400Z-2(b)(2)(D) requires that a QOZ Business acquire such property by purchase. There are, however, a variety of property rights which a QOZ Business may acquire in real property. In addition to fee simple ownership, such acquisition may come via a variety of contractual and derivative property rights, including land leases, timber deeds, agricultural leases, air rights, water rights, mineral rights, easements and options on any of the above. In many cases, the acquisition of such derivative property rights is commonplace in certain rural industries (such as agricultural leases for farming operations) and occurs over a long-term period, such that the rights acquired, although not a direct fee simple interest, effectively transfer a form of long-term ownership of the land.

➤ Accordingly, we are seeking clarification from the Treasury that any of the foregoing contractual rights on real property would qualify as an acquisition by purchase within the meaning of the Code, and that such property, and the substantial improvement thereof, would be eligible for treatment a QOZ business property.

IV. Conclusion

We believe the Opportunity Zone regime presents real potential for expanding business into low-income areas in rural America, and that the Treasury’s proposed regulations for implementing the regime provide a workable framework for enabling such investment in a variety of contexts. With some additional interpretative clarifications regarding (A) the original use of land in rural contexts, (B) how the substantial improvement test will be applied to rural industries, and (C) the types of man-made and natural structures which will be eligible for investment under the Opportunity Zone program, we believe the foregoing regulations and interpretations present a tremendous potential for investment in rural Opportunity Zones.

We appreciate the opportunity to comment on the Proposed Regulations and Ruling. Please feel free to contact Richard Shamos (212) 573-8027 or Alex Gelinas (212) 573-8159 with any questions about this letter.

Sincerely,

/s/ Sadis & Goldberg

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