MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

May 14, 2019

Via Electronic Filing

Internal Revenue Service
CC:PA:LPD:PR (REG-106089-18)
Room 5203
P.O. Box 7604,
Ben Franklin Station
Washington, DC 20044.

Re: MFA Comments on Investing in Qualified Opportunity Funds

Dear Ladies and Gentleman:

Managed Funds Association ("MFA")[1] appreciates the opportunity to respond to the proposed regulations, Investing in Qualified Opportunity Funds (the "Proposed Regulations"),[2] implementing new section 1400Z-2[3] of the Internal Revenue Code of 1986, as amended (the "Code"). Many MFA members and their investors have expressed interest in investing capital into qualified opportunity funds ("QOFs"). We are concerned, however, that some provisions in the Proposed Regulations addressing capital gains arising from section 1256 transactions and offsetting-positions transactions will unduly limit the amount of capital that can be invested in QOFs. We also believe that the rules should be amended to permit tiered partnership structures to meet the definition of a QOF, under appropriate conditions. We believe the suggested amendments to the Proposed Regulations discussed below will invite greater investment capital for QOFs, consistent with the policy objective of section 1400Z-2 and the Proposed Regulations from the Department of the Treasury ("Treasury") and the Internal Revenue Service (the "IRS").

[1] The Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and many other regions where MFA members are market participants.

[2] We note that Treasury and the IRS have released two sets of Proposed Regulations to implement section 1400Z-2, the October 29, 2018 proposal (83 Federal Register, 54279) and the May 1, 2019 proposal (84 Federal Register, 18652).

[3] Section references in this letter refer to Code sections, unless otherwise indicated.

<u>Capital Gains from Section 1256 Contracts</u>

We believe that, as drafted, proposed §1.1400Z2(a)–1(b)(2)(iii)(B) is overly broad in scope by potentially disqualifying all capital gains from section 1256 contracts, rather than limiting the scope to the specific type of offsetting-positions transaction identified by Treasury and the IRS. In considering the appropriate scope of the Proposed Regulations treatment of section 1256 contracts, we note that none of section 1400Z-2, the conference report on the statute,[4] or the Joint Committee on Taxation's "blue book" contain language suggesting capital gains arising from offsetting-positions transactions should be ineligible for deferral under section 1400Z-2. Given the lack of legislative intent to exclude such gains generally, we believe that the broad scope of §1.1400Z2(a)–1(b)(2)(iii)(B) would create an unnecessary limitation on investment in QOFs. This limitation results from the proposed language that provides, if, at any time during the taxable year, a taxpayer has a section 1256 contract that was part of an offsetting-positions transaction and any other position in that transaction was not a section 1256 contract (a "Covered 1256 Transaction"), then no gain from **<u>any</u>** section 1256 contract is an eligible gain with respect to that taxpayer for that year.

For some investors with large investment portfolios, gains from section 1256 contracts may constitute a significant portion of gains that are potentially eligible for deferral under the Proposed Regulations. Moreover, large investment portfolios are likely to have gains from a number of section 1256 contracts that are not a Covered 1256 Transaction, but also may have a limited number of Covered 1256 Transactions. Disqualifying all gains from section 1256 contracts based on even a single Covered Section 1256 Transaction would significantly limit the intended policy goal of encouraging economic growth and investment in qualified opportunity zones. This provision also would significantly limit the benefit of the Proposed Regulations general treatment of section 1256 contracts as it would disqualify a significant amount of the capital gains from section 1256 contracts that would otherwise be treated as eligible gains.

Accordingly, we encourage Treasury and the IRS to modify proposed §1.1400Z2(a)–1(b)(2)(iii)(B) to focus the proposed exclusion more narrowly on gains from Covered 1256 Transactions. Specifically, we encourage Treasury and the IRS to modify the proposed rule to state:

> If, at any time during the taxable year, any of the taxpayer's section 1256 contracts was part of an offsetting positions transaction (as defined in paragraph (b)(2)(iv) of this section) and any other position in that transaction was not a section 1256 contract, then no gain from <u>such</u> section 1256 contract is an eligible gain with respect to that taxpayer in that taxable year.

This approach would give effect to Treasury's determination that capital gains from Covered 1256 Transactions should not be eligible for deferral under the Proposed Regulations while permitting deferral of capital gains from other section 1256 contracts that would otherwise be eligible for deferral. We believe this approach is better tailored to promoting the primary policy goal of section 1400Z-2 and the Proposed Regulations.

[4] An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, Public Law 115-97 (2017) (the "TCJA").

Capital Gains from Offsetting-Positions Transactions

We also are concerned about the broad, proposed prohibition that would treat a wide range of capital gains as ineligible for deferral under the Proposed Regulations if the gain is from a position that is or ever has been part of an offsetting-positions transaction. Proposed §1.1400Z2(a)–1(b)(2)(iv) does not permit deferral of capital gain from a position that is or has been part of an offsetting-positions transaction to be eligible for deferral under proposed §1.1400Z2(a)–1(a). In the preamble to the Proposed Regulations, Treasury and the IRS identified potential administrative challenges in deciding not to permit taxpayers to defer net capital gain related to a straddle after the disposition of all positions in the straddle. However, the preamble did not specifically identify a general policy concern with permitting deferral from capital gains arising from a straddle or other offsetting-positions transaction.

In the absence of a clearly articulated policy concern (beyond tax administration) with permitting net capital gain from a straddle or other offsetting-positions transaction, we believe Treasury and the IRS should consider eliminating or at least minimizing the scope of capital gains subject to the prohibition. In that regard, it is important to note that the proposed definition of "offsetting-positions transaction" is broader than just straddle positions and broader than a taxpayer's current offsetting positions. Of particular concern is the language in the Proposed Regulation that would disqualify capital gains from deferral if the capital gain results from a position that has been part of an offsetting-positions transaction, regardless of when the taxpayer had the offsetting-position, and whether the position is still part of an offsetting-positions transaction.

As drafted, this language would disqualify a wide range of capital gains that would otherwise be eligible for investment in QOFs, which we believe is inconsistent with intended policy objective of section 1400Z-2 and the Proposed Regulations. In addition, we believe that allowing deferral of capital gains resulting from a position that previously was, but no longer is, an offsetting-positions transaction does not present the tax administration concerns raised in the preamble to the Proposed Regulations or other policy concerns. Therefore, to avoid an overly broad exclusion of otherwise eligible capital gains, we encourage Treasury and the IRS to modify the Proposed Regulations to delete the language "or has been" from proposed §1.1400Z2(a)–1(b)(2)(iv). To the extent that Treasury or the IRS have concerns about striking that language entirely, we believe a reasonable approach would be to limit the application of the "or has been" language only to situations where there was an offsetting position after enactment of the TCJA (*i.e.*, permit capital gain from an offsetting-positions transaction if there is no offsetting position after enactment of the TCJA).[5]

Tiered Partnerships

We further encourage Treasury and the IRS to amend the Proposed Regulations to permit greater flexibility in permitting investors to access the benefits of section 1400Z-2 by investing in feeder funds or similar aggregator funds that invest in underlying QOFs. We note that §1.1400Z2(b)–1 (c)(6)(ii)(B) of the Proposed Regulations would permit a taxpayer to make a contribution of an interest in a QOF to another partnership under certain circumstances without the transfer being treated as an inclusion event. While permitting these types of contributions will help

[5] We note that this suggestion is similar to one made by the New York State Bar Association Tax Section in its Report on Proposed Qualified Opportunity Zone Regulations, submitted in response to the Proposed Regulations (January 10, 2019).

facilitate a broader set of investments in QOFs, we believe that permitting investment directly into an aggregator or feeder fund that invests in underlying QOFs will further encourage and facilitate investment in QOFs.

Permitting investment directly into aggregator or feeder funds would provide an efficient and familiar investment structure for investors who want to seek professional investment advice in selecting QOF investments, which we believe will expand the pool of investors seeking to invest capital into QOFs. Permitting direct investment into aggregator or feeder funds also will help expand the pool of investors by providing an efficient mechanism for investors who want to invest in a diversified pool of QOFs, but who may not have sufficient capital to meet investment minimums to invest directly into multiple QOFs. Aggregator or feeder funds sponsored by financial institutions can facilitate increased investment in QOFs by effectively and efficiently addressing both of these issues. We believe that excluding investment into aggregator or feeder funds is likely to limit the scope of investors who are willing and able to invest in QOFs.

If Treasury and the IRS amend the Proposed Regulations to permit direct investment of eligible gains into aggregator or feeder funds, we suggest the amended rule include language similar to language in §1400Z2(b)-1(c)(6)(iv)(B), which applies Section 704(b) and Section 704(c) principles to allocations of income, gain, loss, and deduction, and all distributions.

We believe that Treasury and the IRS could address any anti-abuse concerns by requiring an aggregator or feeder fund to meet two tests for an investor in that fund to be able to access the benefits of section 1400Z-2. First, the aggregator or feeder fund could be permitted to invest only in underlying funds that are themselves QOFs. Second, the aggregator or feeder fund could be required to meet the 90 percent test in section 1400Z-2(d)(1) itself, on a look-through basis. By requiring the underlying funds to be QOFs and requiring the aggregator or feeder fund to meet the QOF requirements on a look-through basis, we believe that the structure would be wholly consistent with the policy and objectives of section 1400Z-2 and there would be little or no risk of abuse. Because aggregator or feeder funds can further the statutory goal of incentivizing investments in qualified opportunity zones without risk of abuse, we encourage Treasury and the IRS to amend the Proposed Regulations to permit investors in such funds to access the benefits of section 1400Z-2.

MFA and its members would welcome an opportunity to meet with the staff from Treasury or the IRS to discuss these and any other issues in connection with implementation of the Proposed Regulations. If you have any questions regarding any of these comments, or if we can provide further information with respect to these or other issues, please do not hesitate to contact the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Mark D. Epley

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/s/ Benjamin Allensworth

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